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IMPROPRIETIES IN U.S. EMBASSY CONTRACTING
ACTIVITIES

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HEARING
BEFORE A
SUBCOMMITTEE OF THE
COMMITTEE ON
GOVERNMENT OPERATIONS
HOUSE OF REPRESENTATIVES
NINETY-NINTH CONGRESS
FIRST SESSION

JULY 31, 1985

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(III)

IMPROPRIETIES IN U.S. EMBASSY CONTRACTING ACTIVITIES

WEDNESDAY, JULY 31, 1985

HOUSE OF REPRESENTATIVES,
LEGISLATION AND NATIONAL SECURITY SUBCOMMITTEE
OF THE COMMITTEE ON GOVERNMENT OPERATIONS,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:05 a.m., in room 2154, Rayburn House Office Building, Hon. Jack Brooks (chairman of the subcommittee) presiding.

Members present: Representatives Jack Brooks, Frank Horton, and John G. Rowland.

Subcommittee staff present: Richard C. Barnes, staff director; Cynthia W. Meadow and Chris P. Cooper, professional staff members; Mary V. Heuer, staff member; and Mary Alice Oliver, secretary; full committee staff: William M. Jones, general counsel; Robert S. Richard, professional staff member; Stephen M. Daniels, minority staff director and counsel; and Thomas F. Houston, minority professional staff, Committee on Government Operations.

OPENING STATEMENT OF CHAIRMAN BROOKS

Mr. Brooks. The subcommittee will come to order.

This morning the subcommittee continues its efforts to improve the Federal Government's contracting procedures. The purpose of today's hearing is to review problems with the administration of contracts between our embassies overseas and their employee associations.

These associations, which are organizations of U.S. employees, serve a valuable and needed service for the employees and their families serving this country abroad, often under difficult circumstances. Although their size varies from post to post, their purpose is to provide benefits for their members. They engage in a wide range of activities, including running commissaries, restaurants, libraries, package and dry goods stores, recreation facilities, and social clubs, among others.

However, in addition to these activities, many associations are now involved in an activity that was surely never envisioned by Congress when it granted the Secretary of State the authority to establish such organizations. Embassies are entering into contracts with their associations to provide people—mostly host country nationals—to perform a variety of support functions, such as building maintenance and security. These contracts cover as many as 10,000

workers, and involve tens of millions of dollars in U.S. Government appropriated funds.

Despite the magnitude of these figures, the Department of State has been slow, if not reluctant, to establish necessary management control and oversight systems. Instead, the Department has chosen to let each embassy oversee the activities of its own association without much, if any, headquarters review.

The results of this neglect are alarming, and cannot be tolerated. We have found that associations are making profits on these contracts in violation of State Department guidelines, that Federal contracting regulations are being disregarded, and that the integrity of the contract negotiation process is being undermined by conflicts of interest.

At the subcommittee's request, the General Accounting Office is currently reviewing these contracting activities, and while GAO has not yet completed this study, we will review its interim findings this morning. After GAO's testimony, we will hear from the Department on what it is doing to correct these problems.

Mr. Horton.

Mr. HORTON. Mr. Chairman, thank you.

I have a statement I would ask unanimous consent that it be included in the record at this point in order to save time.

Mr. BROOKS. Without objection, so ordered.

[Mr. Horton's opening statement follows:]

OPENING STATEMENT OF MR. HORTON

MR. CHAIRMAN, AT A TIME WHEN CONGRESS IS WRESTLING WITH VERY DIFFICULT AND PAINFUL BUDGET DECISIONS, IT IS IMPERATIVE THAT AGENCIES AND DEPARTMENTS AGGRESSIVELY MONITOR AND ACCOUNT FOR EVERY TAX DOLLAR THEY SPEND. THAT'S WHY WE'RE HERE TODAY, ASKING DIFFICULT QUESTIONS ABOUT THE WAY THE STATE DEPARTMENT MONITORS THE CONTRACTING ACTIVITIES OF ITS EMBASSIES AROUND THE WORLD.

AS PERSONNEL CEILINGS ARE LOWERED IN RESPONSE TO A LEGITIMATE PUBLIC CONCERN ABOUT THE NUMBER OF OFFICIAL AMERICANS ABROAD, THE EMBASSIES -- WHICH ARE PRESSED TO CONTINUE THE LEVEL OF SUPPORT SERVICES AVAILABLE AT EACH POST -- HAVE SIMPLY BEEN CONTRACTING WITH EMPLOYEE ASSOCIATIONS FOR A WIDE RANGE OF SERVICES. THE ASSOCIATIONS THEN, FOR A FEE, FIND AND HIRE FOREIGN SERVICE NATIONALS TO PROVIDE ROUTINE, BUT ESSENTIAL, WORK AROUND THE EMBASSIES.

I HAVE NO QUARREL WITH DEVELOPING INNOVATIVE WAYS TO GET REQUIRED WORK PERFORMED. AFTER ALL, IF PERSONNEL CEILINGS ARE DROPPED, THE WORK OF THE EMBASSY MUST STILL GO ON. THE BUILDING STILL NEEDS TO BE CLEANED, SECURITY NEEDS TO BE MAINTAINED, AND LETTERS STILL NEED TO BE FILED.

MY CONCERNS ARE THE SAME CONCERNS I ALWAYS HAVE WHEN FEDERAL DOLLARS ARE SPENT. ARE THE FUNDS BEING SPENT IN A LEGAL AND CAREFUL MANNER? ARE THE FUNDS ADEQUATELY MONITORED? ARE FEDERAL CONTRACTING REGULATIONS BEING FOLLOWED? ARE THE PERSONNEL CEILINGS UNREALISTICALLY LOW?

MR. CHAIRMAN, I HOPE THAT WE FIND TODAY THAT STEPS ARE BEING TAKEN TO CORRECT ANY PROBLEMS AND THAT STATE IS ACTIVELY MOVING TO GET CONTROL OF THE SITUATION. WITH THAT IN MIND, I LOOK FORWARD TO THE HEARING AND JOIN YOU IN WELCOMING OUR WITNESSES.

Mr. BROOKS. Our first witness is Joan M. McCabe, Associate Director for Security and International Relations, National Security and International Affairs Division, U.S. General Accounting Office.

Ms. McCabe directs GAO's work in security assistance and agreements and the management activities of the State Department and the USIA.

She is accompanied today by John Payne, Group Director, and John Trembler, the Evaluator-in-Charge.

We are delighted to have you with us, Ms. McCabe, and you are recognized for such comments as you wish to make.

STATEMENT OF JOAN M. McCABE, ASSOCIATE DIRECTOR, NATIONAL SECURITY AND INTERNATIONAL AFFAIRS DIVISION, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY JOHN PAYNE, GROUP DIRECTOR, AND JOHN TREMBLER, EVALUATOR-IN-CHARGE

Ms. McCABE. Thank you, Mr. Chairman.

I have a detailed statement that I would like to submit for the record, and——

Mr. BROOKS. Without objection, so ordered.

Ms. McCABE. Very good.

Mr. BROOKS. Proceed.

Ms. McCABE. I will now summarize our comments.

Mr. BROOKS. You have not testified a great number of times here, but I want to tell you that we have had a lot of people testify. There are some people whose summaries are longer than their written statements. One could almost read the entire statement slowly, and get through it quicker than summarizing.

But I know that you are more competent than that, and I have implicit faith in you.

Mr. HORTON. Mr. Chairman, if you would yield.

I have had that same experience. The other day another Texan who is the chairman of the Postal Operations Subcommittee, Mickey Leland, could not be there, and he had me presiding at the hearing. I made a speech just like you made, and would you believe that the witness summed it all up in two sentences? I never heard that in 23 years. But that witness did.

Mr. BROOKS. You can take more than that.

Ms. McCABE. OK.

Mr. HORTON. You can have three.

Ms. McCABE. I can guarantee that I am going to be someplace in the middle. My remarks are not going to be longer than our prepared statement, but they are going to be considerably longer than two sentences.

I will get rid of the first page, though.

Providing contractual services to an embassy is clearly beyond the scope of the employee association's traditional activities. The nature of the relationship between an embassy and its association raises certain questions. The association is entirely dependent on the embassy for its livelihood. Embassy personnel sit on the association board and benefit directly from association services and facilities.

Embassies often provide their association with space, utilities, and supplies. As U.S. Government instrumentalities, associations have duty-free privileges, and host governments consistently view employees hired under association contracts as employees of the U.S. Government.

Consequently, we find it difficult to imagine circumstances under which an association could be considered an independent contractor and make judgments and decisions apart from the embassy. The question of the propriety of using associations as contractors is currently under review by our general counsel. We expect a determination in the near future.

Although the practice of contracting for services through employee associations has been going on for years, until recently the Department of State has had only limited information on the nature and extent of these arrangements. Recent but partial information indicates that over 6,500 people are employed, at a cost of \$36 million. We expect this number to go higher as additional information comes in.

Department officials cite several reasons for using associations. Some have pointed to the lack of local contractors, and others have suggested that contracting with an association is a less costly alternative in some cases. Yet there are no indications that posts actually canvass the local market for available services before awarding the contracts, or that posts have made cost comparison studies.

As you know, Mr. Chairman, the problems arising from association contracts with the Government are longstanding. We, as well as State's IG, have over the years identified problems with these arrangements. Our current work indicates problems are continuing. In particular, we found that, contrary to regulations, the associations were profiting from these contracts; that associations were not providing all the services required by the contracts; that as written, some contracts do not follow Federal acquisition regulations; and that some associations are not maintaining adequate accounting records.

In Abidjan, Ankara, and Cairo, the three posts we visited during our initial work, we found that the contracts between the posts and the employee associations, although written as non-personal-service contracts, had all the characteristics of personal-service contracts. Specifically, an employer-employee relationship existed and employees were hired, supervised, and terminated by Government personnel.

At the three posts we visited, each of the associations was making a profit through a management fee being assessed on Government contracts. The fees were arbitrarily set, and were not supported by actual costs incurred. In one instance, the fee was raised to compensate for an unwise purchase decision by the association management. Over the past year or so, Ankara realized \$22,000 in profit, Cairo \$80,000, and Abidjan \$44,000.

During our work at the three embassies, we also noted that one association was not accounting for contract costs, and another association was erroneously charging expenses to the embassy contract. For example, in Abidjan the association could not provide us with costs incurred under the contract. We had to obtain cost data from the embassy's budget and fiscal office. In Ankara, year-end adjust-

ments to reconcile differences between the estimated and actual payroll costs were not being made. Also, embassy contract costs were being overstated because association personnel were charging unrelated costs to the contract.

Oversight by the Department has been minimal. Visibility of post contracting activities is limited. Until recently, virtually no information was available on the types and amounts of contracts in effect, or the numbers of personnel employed overseas under contract. In recent months, the Department has taken several steps to strengthen its oversight capabilities. At this time, it is too early to tell how successful these efforts will be in dealing with the problems. We will be monitoring the results of these efforts during the remainder of our work.

Mr. Chairman, this concludes my statement. I hope it was short enough, and we will be happy to answer any questions you may have.

[Ms. McCabe's prepared statement follows:]

STATEMENT OF
JOAN M. McCABE
ASSOCIATE DIRECTOR, NATIONAL SECURITY AND INTERNATIONAL
AFFAIRS DIVISION
U.S. GENERAL ACCOUNTING OFFICE

Mr. Chairman, Members of the Subcommittee:

I am pleased to be here to discuss the problems related to U.S. embassy service contracts with employee associations at overseas posts. Specifically, Mr. Chairman, you requested that we review the extent to which embassies have entered into contracts with associations, the motivations for using associations as contractors, and the propriety of this arrangement given the dependent relationship between the embassies and the employee associations.

I would like to point out that our work is still ongoing, and what I will present today is a status report, not a detailed or final assessment of the issues raised. Furthermore, our Office of General Counsel is currently reviewing the propriety of contract arrangements between the embassies and the associations and has not yet reached a determination.

Our work thus far has been conducted at the State Department headquarters and at three overseas locations--Ivory Coast, Turkey, and Egypt. We have also done limited work at the other foreign affairs agencies, which are similarly engaged in contracts with employee associations. We are planning additional audit work at other posts and expect a final report at a future date. Today I would like to present information on some of the more significant problems and concerns we have found to date. But before we discuss these in any detail, a little background information would be helpful to better understand the issues.

BACKGROUND

Foreign service posts overseas often require various commercial services, such as building maintenance, vehicle operation and repair, warehousing, janitorial services, gardening, and security. At one time, direct-hire foreign service nationals were employed to provide these services. Because of ceilings on the Department's employment levels, posts increasingly turned to contract personnel for these support services. At this time, the State Department does not have good data on total personnel currently employed under service contracts with the U.S. government or the cost of such contracts.

To obtain personnel for various support functions, embassies frequently contract with their employee associations. Posts use the associations as contractors because they lack the authority to contract directly with the individuals. The Department of State prohibits such contracts between the embassy and individuals unless specifically justified and authorized at the Department level. Direct contracts establish employer/employee relationships and constitute personal service contracts.

The Department is currently studying contracting arrangements at selected posts to determine whether it is more cost effective to perform services in-house or contract out. If it is determined that it is more cost effective to provide services in-house, then the posts may be authorized to contract directly with individuals. At this stage, it is uncertain as to when or whether the practice of contracting through associations will be significantly affected by this study.

PROPRIETY OF USING ASSOCIATIONS

The use of an employee association to provide contractual support services to an embassy is clearly beyond the scope of

associations' traditional types of activities, such as providing commissary, exchange, club, restaurant, and recreational facilities to employees and their dependents at post. There is no explicit prohibition against an association providing a contractual function. However, federal procurement regulations have long provided that contracts shall not knowingly be entered into between the government and organizations which are controlled by government employees, except for the most compelling reasons, such as cases where the needs of the government cannot otherwise be supplied.

The nature of the relationship between an embassy and its association raises certain questions. Specifically, the association is entirely dependent on the embassy for its livelihood. Embassy personnel sit on the association board and benefit directly from association services and facilities; embassies provide various logistical support to associations, such as space, utilities, and supplies; as U.S. government instrumentalities, associations have duty-free privileges; and host governments consistently view employees hired under association contracts as employees of the U.S. government. Under no circumstances can an association be considered an independent contractor and make judgments and decisions apart from the embassy.

The question of the propriety of using associations as contractors is currently under review by our General Counsel. We expect a determination in the near future.

EXTENT OF EMBASSY/ASSOCIATION SERVICE CONTRACTS

Although the practice of contracting for services through employee associations stretches back a decade or more, until recently Department of State data on the nature and extent of these arrangements have been limited.

A 1979 Department survey of post contracting activities identified a total of about 10,000 contract employees under both nonpersonal and personal service contracts. Of this amount, about half were reported as being procured through personal service contract arrangements.

It has only been within the last 18 months that the Department of State has had specific, detailed information on employee association activities, including contractual services with the U.S. government. Information compiled in mid-1984 by State's Office of Commissary and Recreation Affairs documents the widespread nature of embassy/association contracts. Of the 125 posts that responded, 62, or about 50 percent, reported that the employee association supplied contractual services to the U.S. government. The number of contract employees was reported at about 6,000 under contracts totalling about \$27 million. More recent information indicates these totals may be low. With only 83 of 131 associations reporting, over 6,500 persons at an annual cost of over \$36 million have already been identified.

Each of the embassies we visited in April 1985--Cairo, Abidjan, and Ankara--had large contracts with its association. At each post an "umbrella" contract covered services to State and other agencies, such as USIA, DOD, Agriculture, Commerce, and others. In Abidjan and Cairo, where AID had a presence, the association had a separate contract with AID.

Information we collected during our overseas work on the value of association contracts and the number of contract employees is as follows. The totals include data for all U.S. government agencies involved in the contracts.

Post/Association Contracting Data
Obtained At Posts Visited
By GAO

	<u>Abidjan</u>	<u>Ankara</u>	<u>Cairo</u>
Value of contract	\$1.1 million ^a	\$2.1 million ^b	\$4.1 million ^c
Number of contract employees (April 1985)	384	430	889

^aTotal for fiscal year 1984--most complete data available at time of our visit.

^bEstimated contract cost as of April 1985.

^cTotal cost of contract for calendar year 1984.

REASONS FOR CONTRACTS

In each location, embassy officials commented that current ceilings on direct-hire U.S. and foreign service national personnel were not sufficient to provide the level of services required at the posts. The only alternative, officials pointed out, was to turn to contract services, and using the associations was considered the most viable approach.

Department officials cite several reasons for using the associations. For example, some have pointed to the lack of local contractors, and others have suggested that contracting with the association is a less costly alternative in some cases. Yet, there are no indications that posts have actually canvassed the local market for available services, or that posts have made cost-comparison studies (with the exception of those done recently under management's auspices) which document higher cost of contracting with commercial companies.

PROBLEMS NOTED IN POST/ASSOCIATION
CONTRACTUAL ARRANGEMENTS

As you know, Mr. Chairman, the problems arising from association contracts with the government are long-standing deficiencies. We, as well as State's Inspector General, for years, have identified problems in these arrangements, and in addition, our work indicates problems are continuing. In particular, we found that posts were obtaining services through associations under unauthorized personal service contracts; that associations were profiting on these contracts; that associations were not providing all services required by the contracts; that as written, some contracts do not follow federal acquisition regulations; and that some associations were not maintaining adequate accounting records to support activities under the contracts.

Contractual arrangements
are questionable

As I mentioned earlier, the contractual arrangements between embassies and associations are questionable. In Abidjan, Ankara, and Cairo we found that the service contracts between the post and the employee association, although written as nonpersonal service contracts, had all of the characteristics of personal service contracts: specifically, an employer/employee relationship existed and employees were hired, supervised, and terminated by government personnel. Specific information we obtained at the three locations we visited is summarized as follows.

Abidjan - The embassy contract covered administrative services of a continuing nature (for example, security guards, drivers, maintenance personnel). Contract

employees worked side-by-side with permanent embassy personnel. Contract execution was being carried out almost exclusively by post personnel who were doing the recruiting, hiring, supervising, and terminating of contract employees. The embassy's Budget and Fiscal section paid the salaries and any severance payments of the contract employees. The only contract function being performed by the association was the tabulation of employee hours worked and forwarding the data to the embassy paying agent.

Ankara - We observed similar contract practices in Ankara. Embassy employees were performing almost all of the personnel functions (recruiting, hiring, firing) and were supervising the contract employees in their daily work. Services were of a continuing nature and contract personnel worked with direct-hire embassy employees. The association was handling the payroll function, including maintaining employee records and disbursing salary payments. The scope of work to be provided under the contract was not specific but merely listed services covered by the contract.

Cairo - As in Abidjan and Ankara, the contract involved services of a continuing nature, and selection, supervision, and termination of contract personnel was done by embassy employees. Primarily, the association processed the paperwork for hiring and

firing contract employees and handled all payroll functions. The contract did not specify what services were to be provided. The contract was basically a pay mechanism which included some general contract provisions and a listing of contract employees.

Associations are profiting
on contracts with posts

Another area of concern, Mr. Chairman, relates to profits being made by employee associations on contracts with the embassies. Although the contracts do not mention profits, associations are paid a management fee to recover the costs of administering the contract. In many cases, fees are arbitrarily set at higher amounts than the management costs incurred, and as a result, associations make profits.

State Department guidance to the overseas posts, at least since 1982, points out that in contracts between the government and the association, cost should be the basis for establishing the price for the contractual services. Since the association is not an independent enterprise and assumes little or no risk of loss under contracts with the post, there normally is no basis for allowing an association a profit on such contracts. This position was recently reaffirmed by the Department.

Information received by the Department in 1984 from the overseas posts shows that of the 62 associations which reported service contracts with the government, 39 indicated they were making profits from the contracts. The total of all profits amounted to \$1.1 million. The State Department is currently updating this information.

At the three posts we visited, each of the associations was making a profit through the management fee being assessed on the government contracts. The fees were established as a percentage of the contract price (which is a violation of procurement regulations) and were not supported by actual costs incurred. In one instance, the fee was raised to compensate for an unwise purchase decision. The details are as follows:

Abidjan - The association raised the contract management fee from about 4.3 percent to 6 percent in May 1984. The increase was granted to provide additional revenue to the association to avoid bankruptcy. Specifically, the former President of the Board directed the association manager to purchase 2,200 cases of beer at a cost of \$17,000, which later could not be sold. The purchase depleted the association's funds to the extent that it was unable to take delivery of a food order. Consequently, the management fee was raised to provide the necessary funds. Our analysis shows that for fiscal year 1984, the association received management fees totalling \$55,000, and of this amount, we estimated about \$43,700 was profit.

Ankara - As of April 1985, the management fee was 2.5 percent of the contract cost, down from 3 percent at the end of fiscal year 1983. Our analysis of contract costs shows that in 1984 the association's profit was about \$22,000. For 1985, it was estimated at \$31,000.

Cairo - The management fee for State and other government agencies, except AID, was 5 percent of payroll costs--AID paid 5.6 percent. In 1984, the association recorded a profit of about \$80,000 from service contracts with the post, which was the most profitable of the association's activities for the year. Contract profits represented about 85 percent of total association profits for the period.

Association accounting systems were deficient

In order to adequately track costs related to activities under the contract, associations must establish accounting and financial reporting systems. In its guidance to the associations the Department of State outlines certain minimum steps associations should follow to put these systems into place. In addition, in most cases, service contracts stipulate that the association, as the contractor, will maintain accounting records to support transactions related to the contract. During our work overseas, we noted that one association was not accounting for contract costs. Another association was erroneously charging expenses to the embassy service contract. Specific details on these two posts are as follows.

Abidjan - An independent audit of the association's statement of income and expenses for the period July through November 1984 found that the accounting system used by the association did not comply with State Department guidelines. The report noted the absence

of such basic documents as a chart of accounts, a general ledger, an itemized accounting, and inadequate accounting registers. In terms of the embassy service contract, the association had established no accounting system to support costs under the contract. Contract cost data we used in our analysis were obtained from the embassy's Budget and Fiscal Office.

Ankara - Financial statements of the association did not reflect the true position of the association. Year-end adjustments to reconcile differences between the estimated and actual payroll costs were not made. Also, embassy contract costs were being overstated because association accounting personnel were charging the salaries of several snack bar employees to the contract. We estimated this overcharge to be about \$12,000 annually.

Concerns expressed by
other foreign affairs agencies

Other foreign affairs agencies have also noted problems with association contracting activities. For instance, an AID Inspector General's report recently discussed several problems with the service contracts in Liberia, including the failure to specify in the contract the management fee AID was paying to the association, and the de facto personal service nature of the contract. The report also criticized the association's accounting system, its system of internal controls, and AID's monitoring of the contract.

Peace Corps has also complained about embassy contracts at two other posts. These complaints included the use of prohibited cost-plus-percentage-of-cost contracts and other violations of procurement regulations, excessive management fees charged by an association, and being required to reimburse the employee association directly even though the contract was between the embassy and the association.

OVERSIGHT OF EMBASSY/ASSOCIATION
CONTRACTING HAS BEEN MINIMAL

Evidence that these problems have existed for a number of years points to the need for more vigilant oversight of embassy contracting for services with employee associations. At the Department level, the oversight function for service contracting lies with the Deputy Assistant Secretary for Operations and his Office of Commissary and Recreation Affairs. This office was established in October 1983 to provide management counsel, guidance, and oversight for the associations. The office analyzes the associations' financial statements and audits and suggests corrective action if necessary, and maintains liaison with geographic bureaus and the Inspector General's office. (At least this was the situation as of late July 1985--we understand that some changes are in the works which may alter organizational responsibilities for employee associations.)

Our information indicates that oversight by this office has been minimal. Visibility over the contracting activities at post is limited. Until recently, virtually no information was

available on the types and amounts of contracts in effect or the numbers of personnel employed under contract. In fact, the number of associations which have contracts for services with the embassies is still uncertain. Again, until recently, guidance concerning operations of employee associations did not address the issue of contracting with embassies for services. The Deputy Assistant Secretary for Operations has remarked that the Commissary and Recreation Affairs office does not have sufficient staff to effectively oversee the operation of the associations. Furthermore, he stated that the office has tried to avoid involving itself in the micro-management of association operations.

In recent months, however, the Department has initiated several efforts to strengthen its oversight capabilities. Specifically, additional information has been requested from the posts regarding the range and volume of their contracting activities. Some preliminary information indicates that the total number of employees under association contracts and the dollar value of such contracts with the U.S. government may, in fact, be far greater than was disclosed in a previous questionnaire. The Department has also issued more explicit guidelines, which, among other things, prohibit embassy employees involved in embassy procurement to hold positions in the association and prohibit associations from making profits on government contracts. In addition, the Department has requested that associations submit all contracts with any U.S. government agencies to the Commissary and Recreation Affairs office for legal and compliance reviews.

At this time, it's too early to tell how successful these efforts will be in dealing with the problems. Furthermore, although some additional guidelines have been issued to the posts, there are no assurances that the posts will operate any differently than they have in the past. As mentioned previously, posts continue to include profits in service contracts even though they were informed in April 1982 that this was not allowed. We will be monitoring the results of these efforts during the remainder of our work.

Mr. Chairman, this concludes my statement. I will be happy to respond to any questions you may have.

Mr. BROOKS. Thank you very much for a definitive statement. That was very helpful.

At the three posts that you reviewed—Cairo, Abidjan, and Ankara—what was the size of the service contracts between the embassies and the employee associations?

Ms. McCABE. At the three posts, the contracts totaled \$7.3 million, covering about 1,700 employees. The largest contract was in Cairo; it was a little over \$4 million, and it covered almost 900 employees. The contract in Ankara was a little over \$2 million, with 430 employees; Abidjan's contract covered about 380 employees. It was difficult to get an annualized cost there; as best we can estimate, that contract total about \$1.1 million.

Mr. BROOKS. How is the management fee established in contracts between the embassies and the employee associations? Who does that and what is the procedure?

Ms. McCABE. As I indicated very briefly in the statement, we found it to be rather arbitrary and not tied to costs incurred. Typically, it would be a percentage of the salaries and benefits under the contract. We found very little in the way of negotiation of the management fee; in fact, we found very little in the way of negotiations or any aspect of the contract between the associations and the embassies.

The fees seemed to rise and fall based on various decisions. For example, in one instance, one employee association decreased its fee at the request of the embassy. In another case, the fee was increased because the employee association had procured excessive amounts of beer—2,200 cases at \$17,000—and found that it could not sell the beer. Consequently in order to pay for ordered food supplies, the management fee on the contract was raised to cover the loss.

Mr. BROOKS. Were the people who approved those contracts also members of the association?

Ms. McCABE. In that particular case—John?

Mr. BROOKS. Mr. Trembler.

Mr. TREMBLER. The administrative counselor would be responsible for approving any increases in the management fee. This would be discussed with the association, but final approval would come from the administrative counselor.

Mr. BROOKS. So is he a member of the association?

Mr. TREMBLER. He is an ex officio member. He sits on the board, but he cannot vote.

Mr. BROOKS. And all the people who work for him—who prepare bids and contracts, all the middle management—are members of the association; is that right?

Mr. TREMBLER. Right.

Mr. BROOKS. He does not go out himself and dig up these people and do those contracts; he looks at a recommendation from his staff, does he not?

Mr. TREMBLER. Right.

Ms. McCABE. Recently, sir, the Department has issued instructions stating that officers in the contracting function and procurement function at the embassy would not sit on the board of the association, in an attempt to separate that somewhat.

Mr. BROOKS. Yes, sure. We are not going to touch that watermelon, but we are going to cut the vine.

Ms. McCABE. Yes; that is right.

Mr. BROOKS. Do employee associations have adequate management expertise, accounting systems, and internal controls to administer their extensive service contracts with the embassies?

Ms. McCABE. The simple answer is no, they do not. Certainly they do not have people who generally would have the qualifications, nor do they require people with such qualifications to manage multimillion-dollar contracts, which is what we are talking about here. Associations very often draw from the dependent population for their employees, and, of course, that can be a mixed bag. You may have some very well-qualified people among the dependent population and in other cases they may lack qualifications altogether.

Considering, though, that the embassies are actually providing many of the management functions that the employee associations are supposed to provide under the contract but are not doing, the management problem is somewhat mitigated. But we have found problems at posts which could be traced to the fact that those managing the contracts did not have accounting skills—for example, recordkeeping problems, uncontrolled costs, charging costs to wrong contracts.

Mr. BROOKS. In what ways do the contracts and the contracting procedures that you reviewed violate the Federal acquisition regulation, the FAR?

Ms. McCABE. Mr. Payne will answer that.

Mr. BROOKS. All right. Mr. Payne.

Mr. PAYNE. Mr. Chairman, we have found a number of problems in this area. In at least a couple of cases, we believe there are specific violations of Federal acquisition regulations. This includes contracts which are entered into on a cost-plus or percentage-of-cost basis. These contracts are prohibited types of contracts, because they allow a contractor to increase his profit merely by incurring additional cost.

The second area that appears to be a violation of the Federal acquisition regulations is that contracts do not contain the required specificity in terms of what the contractor is supposed to perform.

We found a number of other improprieties or questionable practices in these contractual arrangements. One includes that embassy employees were performing work that was specified in the contract as the responsibility of the employee association. We also found employee associations not establishing adequate contingencies for liabilities such as severance pay of individuals. We found that contracts in some cases did not include mandatory language in terms of what happens in case of default or how payments will be made. And we also found the whole question of the personal service nature of the contract to be a questionable area which, as Ms. McCabe indicated, is under review by our general counsel.

Mr. BROOKS. Are the recent initiatives of the Department of State sufficient to stop the abuses that have been discovered to date?

Ms. McCABE. That is hard to judge at this point. We are certainly going to be looking at that in our followup work. Some of the

things that they are doing, such as reemphasizing the Federal acquisition regulations and prohibiting profits by the employee associations on these contracts are things that have been policy for years, and yet they have not been enforced.

So I think we have to see how the management and monitoring of this program will proceed before we can say whether these initiatives will resolve the problems.

Mr. BROOKS. I think that is very wise, to watch and see what they do, not what they say.

Now, how useful are the annual audits of these associations when you review their procedures for administering service contracts with their respective embassies?

Ms. McCABE. We have not found them to be very useful. Most of the annual audits are silent on the embassy contract. In fact, auditors at one of the posts we visited had been instructed not to include in their audit the service contract. This is surprising, since the contract is generally the single largest activity dollar-wise that employee associations have, and to exclude them from the audit does not make sense to us.

Mr. BROOKS. Mr. Horton.

Mr. HORTON. Thank you, Mr. Chairman.

Ms. McCabe, in point of time, what is the status of your study of this problem? Are you halfway through, three quarters of the way through?

Ms. McCABE. Halfway through is probably a good way of putting it. On the initial round, we went to, as we indicated, Abidjan, Cairo, and Ankara. We are now planning to visit three more posts. Some of those posts we will be looking at are in developed countries where commercial contractors are more likely to be available than they have been in some of our previously visited locations.

We are also going to be following up on some of these initiatives, and that will require more work in those additional countries.

Mr. HORTON. Could you name those countries now?

Ms. McCABE. The ones we have picked to go to now are Paris, London, and Mexico City.

Mr. BROOKS. That is a better deal than the last group of embassies.

Ms. McCABE. Oh, yes, we always try to get the tough ones out of the way first. That keeps staff morale up.

Mr. BROOKS. Wear your gas mask when you go to Mexico City; the air is still not that good.

Mr. HORTON. What about the Far East? Do you intend to look at any of those?

Ms. McCABE. We had not planned at this time to include any in the Far East. We assumed that the sample that we had chosen would get the various types of contracts that we wanted to include, plus different kinds of operating conditions.

We always wanted to, given the fact we would be testifying on it at this time, complete the audit work as quickly as possible and get a report up to you.

Mr. HORTON. What kind of samples do you get, will you propose to get, or have you gotten—from the State Department with regard to these other embassies that you have not visited or do not plan to visit?

You understand my question?

Mr. TREMBLER: Based on the information in response to questionnaires the Department has sent out, the problem is widespread in other embassies. Also State's IG has pointed out that the problem is widespread, and exists in countries we are not going to visit.

Mr. HORTON. Well, I understand that, but I am talking more about procedure and technique than I am about what you found.

What procedures are you using and what technique are you using to cover these embassies that you are not going to actually visit and make an onsite inspection?

Ms. McCABE. The Department is currently obtaining information on the universe of contracts that employee associations have entered into with the Government, and we are keeping tabs on that. So far they have received 80 responses out of potential 131 associations reporting. At this point, posts have identified about 6,500 persons working under contracts valued at \$36 million.

We are identifying the universe, and we are going out to these six selected posts to look at the particular conditions. But our study will be looking at the universe, and what the Department is doing to control employee association contracts elsewhere also.

Mr. HORTON. I am particularly concerned about two areas. One is the conflict of interest, and the other is the problem of sweetheart contracts or entered-into contracts that are not neither negotiated nor bid and that sort of thing. Are you looking at those problems?

Ms. McCABE. The Department currently is making some studies along the line of A-76 domestically where they are looking at some of the embassies' commercial functions to determine whether they should be done in-house or out-of-house. They will be conducting these reviews over the next several years at all posts.

So that would be one thing that we would be looking at. In connection, though, with the Department's effort to identify the universe, they are also calling for copies of all contracts that the employee associations have with the Government. We would be able to look at those as part of our review. And if we identify any items that indicate there are some peculiarities in the contract, they would become subjects of our review.

Mr. HORTON. Well, I am particularly concerned about your statement that in one of the embassies they had a lot of beer that did not sell and then the embassy raised the management fee to cover the loss on that. Now, if they are nonprofit they ought not to be making profit, but apparently, from what you are saying, they are making profit.

But when you talk about profit vis-a-vis nonprofit, they could include whatever they want on this management fee, and, of course, that is not a profit per se; that is an expense, I guess. And I think you have to look at that pretty carefully to make certain that charges that are being made are justifiable and reasonable and can be supported.

Ms. McCABE. Yes.

Mr. HORTON. And perhaps by comparison with other charges in the vicinity.

Ms. McCABE. We are clearly looking at that at the posts when we are going through their records. In fact, at one of the posts we found out that they were charging the embassy contract for some

snack bar employees—that is, employees working in the employee association snack bar. Clearly, they were not contract costs; clearly, they were applied erroneously. We are seeking to identify those instances, and when we do, we raise them.

Mr. HORTON. Talking about that beer situation, what efforts, if any, have been made to recoup that?

Ms. McCABE. The beer situation was not a case of erroneous charges to the contract. Instead, it was a case of the management fee, which had been 4.3 percent of salaries and benefits, being raised.

Due to the association's financial straits because of this unwise beer purchase, the association's management fee was increased to 6 percent. With the management fee increased to 6 percent, the association made more profit, and they used the profit to cover their loss.

Mr. HORTON. Well, it seems to me that there ought to be some way to recoup that, but apparently nothing has been done on it; is that right?

Ms. McCABE. Clearly, according to State policy, these organizations are not to make profit. And we find that clearly they are making profit. In fact, they openly acknowledge it. It is not a case of everyone is out there hiding the fact that they are making profit.

In a survey conducted last year, a number of associations reported that they were making profits which, when totaled, was in excess of \$1 million.

Mr. HORTON. And that is out of appropriated funds?

Ms. McCABE. That is right.

Mr. HORTON. On page 5 of your statement, you say that about 50 percent of the 125 associations supply contractual services to the Government. What does that suggest about the other 50 percent? Are half of the embassies finding other ways to cope with reduced personnel ceilings, and if so, what are those alternatives?

Mr. TREMBLER. Well, there is some question whether they are reporting accurately, too. In a number of surveys that have been done by the Department about these contracts, there was some question about what the posts are actually reporting.

The numbers may be low. Even though there are 50 percent that said that they do not have these types of contracts, we are not sure they are reporting them properly.

Mr. HORTON. Do you think there is a possibility there are more; in other words, more associations that are supplying contractual services?

Mr. TREMBLER. Yes. If you compare the numbers from the mid-1984 questionnaire and the current questionnaire, the numbers have increased. They are getting additional figures and numbers of personnel and dollars coming in now. It is likely that there are some more out there.

Mr. HORTON. In other words, as the heat goes on, they begin to get a little upset and concerned, and perhaps they are now trying to report something that they had not been reporting?

Mr. TREMBLER. Right.

Mr. HORTON. Are you making recommendations with regard to that reporting by these associations?

Ms. McCABE. We expect to be making recommendations at the conclusion of our review, and these recommendations will address the types of steps we think need to be taken to bring these things into line, and better monitor them.

Mr. HORTON. What is your assessment of the information compiled last year by State's Office of Commissary and Recreation Affairs? Does the information appear to be accurate and substantiated?

Mr. TREMBLER. We saw some inconsistencies, and in discussing them with the Department people in that office, they also had questions about the data. And that is why they went out again with new questionnaires this year to update and validate the previous information. There could be different interpretations of questions at the different posts.

Mr. HORTON. Was the information gathered solely by questionnaire?

Mr. TREMBLER. As far as we know, yes.

Mr. HORTON. So you do not know of any other sources that they might have used?

Mr. TREMBLER. No.

Mr. HORTON. I have some other questions, but I think at this point I will just submit them to you, and ask that you submit the answers in writing so that we can save a little time here.

Ms. McCABE. Fine.

Mr. HORTON. The House will be going in shortly, and we have to go over to do some voting.

So thank you very much for the information, and I urge you to continue doing what you are doing.

And I guess I would ask one more question, and that is this: Do you feel that this has been a pretty sloppy operation as far as State is concerned?

Ms. McCABE. It has been an operation that has not gotten the attention that many other operations have gotten in the Department. Also this operation has not been staffed to monitor these many, many contracts. And there is also a question as to whether the employee association staff back here in the Office of Commissary and Recreation Affairs should be the ones trying to keep tabs on what is a much larger management problem within the Department, and that is how to obtain commercial-type services overseas.

Mr. HORTON. OK, thanks.

[Ms. McCabe's submissions to additional questions of Mr. Horton follow:]

ADDITIONAL QUESTIONS OF MR. HORTON
FOR MS. MC CABE

1. YOU TELL US ON PAGE 6 THAT, IN THE THREE LOCATIONS YOU VISITED FOR THIS STUDY, EMBASSY OFFICIALS FEEL THAT CURRENT PERSONNEL CEILINGS ARE NOT SUFFICIENT TO PROVIDE THE LEVEL OF SERVICES REQUIRED AT THE POSTS. WHAT MAKES THESE POSTS DIFFERENT FROM THE 50 PERCENT THAT DO NOT USE CONTRACT ARRANGEMENTS WITH THEIR EMPLOYEE ASSOCIATIONS?

There are a significant number of posts worldwide that because of their small size do not have employee associations. Some other posts report they do not use their associations as contractors. Two possible explanations for how these posts are acquiring support services are (1) there are legitimate, commercial contractors available to provide these services or (2) the posts have a sufficient number of direct-hire, foreign service nationals to perform the work. As part of our ongoing efforts, we will be doing more work on the issue of personnel ceilings as it relates to embassy contracting with employee associations.

2. WHAT HAVE YOU DISCOVERED ABOUT PERSONNEL CEILINGS AT OUR EMBASSIES? ARE YOU FINDING, FOR EXAMPLE, THAT THEY ARE UNIFORMLY TOO LOW AND UNREALISTIC OR THAT THEY ARE GENERALLY SUFFICIENT?

Evaluating whether personnel ceilings are too low to adequately meet mission needs is not a part of our current study. Instead, our work has focused on embassy arrangements with employee associations to provide additional support personnel. In the majority of cases, the employees performing support functions are foreign nationals, not American citizens. Consequently, raising the ceiling on the number of direct-hires authorized at post would not necessarily detract from broader government efforts to reduce the number of American officials overseas.

In terms of meeting our security needs abroad, the Department has actually increased the number of security officers at posts worldwide. Embassies have also made efforts to tighten security by hiring additional guards through employee associations.

3. HOW LONG HAS GAO BEEN AWARE OF, AND REPORTING ON, PROBLEMS WITH THESE EMPLOYEE ASSOCIATIONS? MORE SPECIFICALLY, HOW LONG HAVE YOU BEEN REPORTING ON PROBLEMS WITH CONTRACTUAL ARRANGEMENTS WITH THE ASSOCIATIONS?

Both GAO and State's Inspector General have reported on problems related to the contractual arrangements between embassies and employee associations at least since 1973. However, little, if any, action has been taken to remedy these often cited deficiencies.

Recent initiatives instituted by the Department include instructions to posts which (a) prohibit employees

in the embassy procurement process from serving in a position in an employee association which has a contractual relationship with the embassy, (b) reemphasize that all procurement actions at post be in accordance with FARs, including competitive solicitations and justifications for sole-source purchases, (c) require all existing and future contracts between associations and embassies to be submitted to headquarters for review and approval, and (d) disallow profits on future contracts.

At this time, it is too early to tell how successful the recent initiatives will be in dealing with the association contracting activities. This area is one which we intend to pursue further during the remainder of our work.

4. WHAT IMPACT, IF ANY, WILL STATE'S NEW FINANCIAL MANAGEMENT SYSTEM HAVE ON EMPLOYEE ASSOCIATIONS AND THEIR CONTRACTING ARRANGEMENTS WITH EMBASSIES?

It does not appear that State's new financial management system will enable the Department to more closely monitor embassy contracts with employee associations. While the system will allow the Department greater visibility over post expenditures for security guards, buildings maintenance, and other support services, it will not provide the details on embassy contracts with associations.

Mr. Brooks. Well, thank you very much.

And I am sure there are many entrepreneurs in the State Department. I hate to think back of my activities as a young Marine Corps officer in charge of the wine mess and other commodities of great interest to marines during World War II. But I can assure you that junior management can live very well, very well.

I have several more questions which I would like to submit for the record. Ms. McCabe, Mr. Payne, and Mr. Trembler, we are delighted and appreciate your being here, and thank you very much.

Ms. McCABE. Thank you very much.

Mr. PAYNE. Thank you.

Mr. TREMBLER. Thank you.

[Ms. McCabe's submissions to additional questions of Mr. Brooks follow:]

ADDITIONAL QUESTIONS OF MR. BROOKS
FOR MS. NC CABE

1. WHAT IS THE DIFFERENCE BETWEEN A PERSONAL SERVICE CONTRACT AND A NON-PERSONAL SERVICE CONTRACT?

The basic difference between a non-personal service contract and a personal service contract is the amount of control exercised by the government. Under a non-personal service contract, services are provided by independent contractors and the government does not directly supervise work performed by contract employees and does not reserve the right of selection or dismissal of such employees. In a personal service contract, an employer/employee relationship is established and contract employees are hired, supervised, and terminated by the government.

According to State Department regulations, "contracting officers should be alert to the following conditions or circumstances, which, if present, could result in an improper personal service contract, if with:

- (1) An individual. (i) the contract does not call for an end product which is adequately described in the contract,
(ii) the contract price or fee is based on the time actually worked rather than the results to be accomplished,

(iii) the services are to be of a continuing rather than a temporary or intermittent nature, and

(iv) the services to be performed are usually performed by government employees under the supervision of a government official.

(2) A Concern. (i) Office space, equipment, and supplies necessary for contract performance are to be furnished by the Department,

(ii) contractor-furnished personnel are to be integrated within the organizational structure of the Department,

(iii) contractor-furnished personnel are to be used interchangeably with Department personnel to perform the same functions,

(iv) the Department retains the right to control and direct the means and methods by which contractor-furnished personnel accomplish the work, and

(c) if in the opinion of the contracting officer any of the conditions or circumstances in this section are present, he will endeavor to resolve all doubts regarding the propriety of the proposed contract."

2. WHY DO EMBASSIES ENTER INTO CONTRACTS WITH THEIR EMPLOYEE ASSOCIATIONS FOR SERVICES, PARTICULARLY WHERE THERE ARE INDEPENDENT LOCAL CONTRACTORS WHO COULD PROVIDE NECESSARY SERVICES?

It appears that embassies first entered into contracts with employee associations many years ago in order to absorb personnel ceiling reductions. Officials readily acknowledge that contracts were necessary in order to provide the types and levels of service which were considered required by the embassy. Why they chose employee associations as the vehicle to accomplish this is not so clear. Some have told us it was because there were no local contractors available; however, this is not true in many locations and in most cases the embassy does not even look for them.

Some posts officials have stated they have used the associations because such a contract arrangement was in place prior to their arrival at posts. As a matter of convenience, then, posts continued to rely on associations for contract personnel. In addition, using the associations allows embassy personnel greater control over the contract staff than would be possible with an independent local contractor.

Department officials have defended the use of the association in countries where they say there are few or no

available local contractors, or where VAT, would make contracting through commercial contractors more expensive than contracting through the associations. I should mention, however, that we did not find any formal evidence at the posts we visited to suggest the embassy had actually sought out local contractors, nor conducted cost-comparison surveys where contractors were available.

3. GIVEN THE CLOSE, DEPENDENT RELATIONSHIP BETWEEN EMPLOYEE ASSOCIATIONS AND THEIR CONSTITUENT EMBASSIES, CAN CONTRACTS BETWEEN THEM BE VIEWED AS "ARMS LENGTH" TRANSACTIONS?

We see no way the contracts can be viewed as "arms length." The association is entirely dependent on the embassy for its livelihood. Specifically, embassy personnel sit on the association board and benefit directly from association services and activities; embassies provide logistical support to associations, such as space, utilities and supplies; as U.S. government instrumentalities, associations have duty free privileges; and host governments consistently view employees hired under association contracts as employees of the U.S. government. Since all association decisions are made and approved by mission personnel, thus depriving associations of any latitude to make decisions independently from the U.S. government, there appears to be no way the contracts can be considered "arms length" nor any way an embassy can enter into a legitimate non-personal service contract with an association.

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4. **HOW EFFECTIVE IS THE STATE DEPARTMENT'S BUDGET PROCESS FOR DETERMINING WHETHER THERE IS A PROPER JUSTIFICATION FOR CONTRACT EMPLOYEES AT OVERSEAS POSTS?**

There presently is no system for evaluating the justification for contract employees beyond the post level. In fact, until recently, there was no visibility of any of the contracting activity. The budget process is not an effective way to evaluate the justification for contract employees. Until recently, no information on the numbers of contract personnel went beyond the post where they were employed (except in one case involving a questionnaire in 1979). Also, since posts can reprogram funds received from one program to another, the budget process does not even control the expenditures for the various types of services procured. However, placing limits on funds allotted (disallow reprogramming) and requiring approval by the bureaus for all increases to the contracts would be one way to more closely monitor service contracts and address justification of employees.

5. **WHAT ARE THE WEAKNESSES IN THE STATE DEPARTMENT'S PROCEDURES FOR MONITORING CONTRACTS BETWEEN OVERSEAS POSTS AND THEIR EMPLOYEE ASSOCIATIONS?**

A key weakness in the Department's monitoring system for contracts between embassies and associations is the lack of basic contract data. In fact, the Department is not certain as to how many associations there are or how many have contracts for services with the embassies. State has only recently requested that posts submit copies of these contracts. In addition, information collected on the number of contract employees and contract costs still is being validated. Another critical factor which impacts on the monitoring of these contracts is that State has not issued any uniform procedures and practices for executing and administering contracts between the association and the embassies.

6. WHY HAVE THE EFFORTS OF THE STATE DEPARTMENT INSPECTOR GENERAL APPARENTLY BEEN INEFFECTIVE IN BRINGING ABOUT CORRECTIONS TO THE PROBLEMS IN THE USE OF EMPLOYEE ASSOCIATIONS FOR EMBASSY CONTRACTS?

Based on our work, it appears that the State IG has been effective in identifying and bringing to management's attention the problems in the contracting practices between employee associations and embassies. The problem has been the failure of the embassies and headquarters officials to act on the problems pointed out by the IG. We do not know exactly why the problems were ignored for over 10-15 years or why the Department only recently began to take them more seriously. We do know that it was not because the problems were not known.

7. WHAT SPECIFIC STEPS WOULD YOU SUGGEST BE TAKEN BY THE DEPARTMENT OF STATE TO IMPROVE ITS PROCUREMENT PRACTICES AT OVERSEAS POSTS?

Again, our work is in process and we are not yet in a position to offer our conclusions and recommendations on improvements needed. Based on our work to date, however, there are a number of areas which appear to warrant attention. First, the Department needs more visibility over the contracting activities of posts. As we have mentioned virtually no data was available (until recently) on the types and amounts of contracts in effect. Second, the Department needs to prescribe, monitor, and enforce uniform guidelines concerning the contracting activities between employee associations and embassies. We believe this is needed to achieve some consistency, to assure that the FARs and other pertinent procurement requirements are adhered to, to avoid recurring problems, and to formalize what presently are largely informal arrangements between associations and embassies.

8. HOW RELIABLE IS THE INFORMATION ON EMBASSY CONTRACTS WITH EMPLOYEE ASSOCIATIONS THAT IS MAINTAINED BY THE OFFICE OF COMMISSARY AND RECREATION AFFAIRS?

There are some questions about the reliability of such data and even greater questions about completeness. Until recently, the Office of Commissary and Recreation Affairs maintained virtually no information on the associations' contracting activities. In fact, the actual number of associations which exist is not known. Last fall CR compiled a data base from association responses to a questionnaire, which asked for, among other things, number of employees, the value of the contract, and amount of profit made on the contracts. However, due perhaps to some misinterpretations of the questions by the posts, the data contained various inconsistencies and contradictions. CR has acknowledged these problems and, in efforts to get more accurate data, recently sent out another questionnaire. About 50 percent of the responses have been received to date. Preliminary indications are that data compiled from the responses to the second set of questionnaires will differ significantly from the data compiled from the responses to the first set. In terms of information on contracts themselves, CR had no contracts on file until the office requested associations send in all contracts for review this past June. The reliability and completeness problems may prevent the Department from applying appropriate remedies without additional data collection.

9. TO WHAT EXTENT ARE AGENCIES OTHER THAN THE DEPARTMENT OF STATE INVOLVED IN SERVICE CONTRACTS WITH EMPLOYEE ASSOCIATIONS?

At the posts we visited, other agencies such as USIA, Peace Corps, AID, and DOD were at least indirectly involved in contracts with employee associations. With the exception of AID, most of these agencies did not maintain separate contracts with the association. Instead, they received such services under an "umbrella" contract between the embassy and the association. In most cases, the agencies reimbursed the embassy for the cost of the services provided. In at least one location, however, the Peace Corps, which was not a signatory to the embassy/association contract, was instructed to pay the association directly, rather than reimburse the embassy for its share of contract costs. At the same time, AID, in many cases, maintains a separate contract with associations, but all related administrative functions are carried out in the same manner provided under the embassy contract.

10. WHAT STEPS, IF ANY, SHOULD BE TAKEN TO IMPROVE THE USEFULNESS OF ASSOCIATIONS' ANNUAL AUDITS AS A MEANS OF REVIEWING THEIR PROCEDURES FOR ADMINISTERING SERVICE CONTRACTS WITH EMBASSIES?

At present, the annual audits are not very useful for reviewing association contracting activity. In some cases the associations' activity in service contracting is not even addressed in the annual audit. Since association contracts with the embassy usually represent the largest association activity, in terms of dollar value, we believe it is essential that this function be independently reviewed as part of the annual audit. Based on our work to date, we have identified several cases where the annual audit did not cover the contracting activity with the embassy. In one case, the association specifically instructed the audit group to exclude this area from the annual audit.

The annual audit would not substitute for oversight of the contracting activity. It would not, for example, deal with justifications for employees, competition, and the like. It should, however, address administrative costs, profits, controls over association funds, and a variety of similar financial management practices.

11. PLEASE PROVIDE A LISTING OF THE TYPES OF WORKERS COVERED BY THE SERVICE CONTRACTS BETWEEN THE EMBASSY AND THE EMPLOYEE ASSOCIATION.

At the three posts we visited, most of the employees under the association service contract were in the security and general services areas. However, at one post we noted that the embassy hired a computer specialist under the association contract to manage the embassy computer system. Day-to-day supervision of this employee was provided by embassy personnel. A listing of the various types of workers are shown below:

Security Guards	Personnel Assistant
Janitorial Forces	Voucher Examiner
Gardeners	Budget and Fiscal
Maintenance (Electricians,	Assistant
Carpenters, Plumbers,	Printers
Welders, Masons, etc.)	Tailors
Chauffeurs (Drivers)	Shipping/Supply
Messenger/Mail	Clerks
Secretaries/Receptionists	
Clerk/Typist	
Consular Assistant	

12. WHAT WORK CURRENTLY PERFORMED UNDER CONTRACT WITH THE ASSOCIATIONS SHOULD BE PERFORMED IN-HOUSE?

Deciding what work should be done in-house rather than under contract or whether a function is best performed with direct-hire or contract staff is beyond the scope of this study. This issue is the thrust of the State Department's current A-76 project, which basically uses cost as the deciding factor. We generally agree with the approach. Our work to date has focused on the particular contract arrangements between the associations and the U.S. government--particularly, in reference to the fitness of the association to act as contractor under any circumstances and the contract performance itself.

13. WHAT PROBLEM AREAS WILL YOU FOCUS ON IN THE SECOND HALF OF YOUR REVIEW?

During the next phase of our review, we will be focusing on problem areas similar to those identified in the initial phase, but on a broader scale. For example, we will be doing work at posts in developed countries where commercial contractors are likely to be available, but the post is using the association as a contractor. Also, we will be monitoring the results and impact of recent State initiatives to improve its oversight of association contracting activities.

Mr. BROOKS. Our next witness is John Condayan, Acting Assistant Secretary of State for Administration. He is a career administrative officer, member of the senior Foreign Service, and is responsible for overseeing a broad range of services to support the State Department's domestic and overseas administrative programs.

Accompanying him are Richard C. Faulk, Deputy Director in the Office of Operations, and Ravi Sikand—is Sikand correct?

Mr. SIKAND. Yes, sir.

Mr. BROOKS. Mr. Sikand is Director of the Office of Commissary and Recreation Affairs.

Gentlemen, we welcome you to this hearing.

Mr. Condayan, you can proceed with your statement. We will accept it for the record. You can summarize it, or you can read it, whatever you want to do.

STATEMENT OF JOHN CONDAYAN, ACTING ASSISTANT SECRETARY FOR ADMINISTRATION, U.S. DEPARTMENT OF STATE, ACCOMPANIED BY RICHARD C. FAULK, DEPUTY DIRECTOR, OFFICE OF OPERATIONS, AND RAVI SIKAND, DIRECTOR, OFFICE OF COMMISSARY AND RECREATION AFFAIRS

Mr. CONDAYAN. Thank you, Mr. Chairman.

I have a statement which I would like to submit for the record, and which I would like to briefly summarize at this point.

Mr. BROOKS. All right. Without objection, so ordered, and the gentleman is recognized.

Mr. CONDAYAN. Thank you, sir.

Mr. Chairman, the Department of State shares your concern over the problems that have come to light with some of the service contracts. We, as have the Inspector General of the Foreign Service, GAO, and this committee, have been aware that all the appropriate regulations concerning contracting may not have been carefully complied with.

However, it is only recently that we have actively pursued this phase of our overseas activities. As a result of our efforts, we are much more aware of what the problems are and where they are. We have taken some corrective actions, and we believe we have greatly reduced the potential for irregularities and improprieties.

We are very serious about putting our house in order and in providing our employees associations with the appropriate guidelines and direction which will minimize the future potential for recurrence of similar problems.

I would like to point out some of the conditions that need to be factored into our decisions and actions. Our employees associations are providing our embassies and all of the U.S. Government employees abroad some very essential morale and material support, as well as services which are not otherwise readily available. The availability of trained and competent personnel in various employment categories which we may require varies greatly from country to country. In some cases, the services provided are just more efficiently done through contractual arrangement as opposed to direct hire or staff. Our overseas environment is impacted by difficult political problems, corruption, unacceptable labor standards, varying

work ethics, extremely low rates of literacy and competency, and other unique country-specific problems.

As you are all aware, security has also become a very significant factor for us. Within the last few years, there has been a great demand for security guards, and as a result, contractual guard services have increased significantly. In order for the security service to be meaningful, it requires more direct supervision and effective control of hiring and training.

Since 1983, the Department has taken a much more active role in overseeing the employees associations and assisting them through directives and other initiatives. It presently does and will continue to provide policy guidance and regulations to assist ambassadors in supervising the daily activities of their associations. The Office of Commissary and Recreation has issued a number of directives to the employees associations concerning the operations of their activities. These directives outline their relationship with the embassy, provide detailed instructions to auditors, and reiterate the association's financial accountability and reporting responsibility. Included in this category are our most recent regulations and guidelines for contracting, which not only specifically eliminate all profits from such contractual arrangements, but also requires that all such contracts be reviewed for compliance to the Department of State's contracting regulations.

In the future, I visualize a greater outreach program by this office. By outreach, I mean more visits to posts and a greater management consultant role. Through an active program of that nature, I hope we can be of greater assistance to our employees associations and also head off the potential problem.

We in the Department have taken active steps to eliminate abuse and mismanagement. By definition, our employees associations are nonprofit organizations, and in regard to contracts with the U.S. Government, we intend to see that they are, in fact, nonprofit.

We will be pleased to supply any additional information you may desire regarding this or any other matter involved in the management and the administration of our employees associations.

...[Mr. Condayan's prepared statement follows:]

STATEMENT OF ACTING ASSISTANT SECRETARY FOR
ADMINISTRATION, JOHN CONDAYAN
LEGISLATION AND NATIONAL SECURITY SUBCOMMITTEE
OF THE
COMMITTEE ON GOVERNMENT OPERATIONS

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to appear before you today to address questions you may have concerning the contractual relationships and the contractual services provided by our Employees Associations at overseas posts. You have copies of my prepared statement. With your permission I would like to submit it for the record and, if it pleases the Subcommittee, I will summarize it briefly.

Mr. Chairman, the Department shares your concern over the problems that have come to light with some of the service contracts. We, as has the Inspector General of the Foreign Service and this Committee, have been aware that all of the appropriate regulations concerning contracting may not have been carefully complied with. However, it is only recently that we have actively pursued this phase of our overseas activities. As a result of our efforts, we are much more aware of what the problems are and where they are. We have taken some corrective actions and we believe we have greatly reduced the potential for irregularities or improprieties.

Your interest and activities in reviewing the operations of our Employee Associations and their contracting practices is very timely and most welcomed by us. As I will outline presently, we are very serious about putting our house in order and providing the appropriate guidelines and direction which will minimize the potential in the future for such problems.

Not in the way of excuses but as aids to understanding the complexity of our undertaking, I would like to point out some of the conditions that need to be factored into our decisions and actions. Under some of these contractual arrangements, our Employees Associations are providing our Embassies and all of the U.S. Government Employees abroad some very essential morale and material support as well as services, which are not otherwise readily available. Often times manpower and other services are provided by the Employee Associations much more cheaply than we can obtain them from other sources. The availability of trained and competent personnel in the various employment categories which we may require varies greatly from

country to country. In some cases the services provided are just more efficiently done through a contractual arrangement as opposed to direct hire of staff (i.e., custodial, maintenance and landscaping). No two situations or countries where we are located are alike. Our overseas environment is impacted by difficult political problems, corruption, unacceptable labor standards and various work ethics, extremely low rates of literacy and competency, and other unique country specific problems.

In addition, whenever and wherever possible, we want to attract and hire Foreign Service spouses and dependents. This practice is not only good for the morale of our families, but it provides us with an unusually qualified, loyal, and dedicated pool of potential employees. As you are all aware, Security has become a very significant factor for us. We cannot rely solely on cost factors when we determine who shall have access to our Embassies, our Consulates, our supply centers, etc., or the information that is available within our facilities. Additionally, within the last few years there has been a great demand for security guards, and, as a result, contractual guard services have increased significantly. Contractual Guard services as we know them in this country are not readily available in all of the countries where we need them. In order for the security service to be meaningful, it requires more direct supervision and effective control of hiring and training. Many times this is best accomplished through our associations.

As I stated, I cite these as some of the factors besides cost we have to consider when we award service contract. Mr. Chairman, I would like to give some background on our Employee Commissary and Recreation Associations and their operations. Since the specific purpose of this hearing is to concentrate on the contracting relationships between our overseas posts and their employee associations, I will limit my remarks to that relationship. In addition and related to contracting, I would like to highlight a number of initiatives and regulatory changes which the Department has already taken to improve its oversight responsibility.

The legal authority for the Department to provide for Employee Associations at posts abroad is contained in Section 31(a) of the State Department Basic Authorities Act, enacted by Public Law 96-465, which invests in the Secretary of State the authority to authorize and assist in the establishment, maintenance and operation by civilian officers and employees of non-government operated services and facilities at posts abroad, and in provisions of the Foreign Services Buildings Act, 1926 (22USC-292-300). This authority is implemented

through regulations contained in Chapter 500, Volume 6, of the Foreign Affairs Manual. The Authority vested in the Secretary is delegated to the Principal Officer at each overseas post to be exercised in accordance with the Departmental directives and regulations. The Deputy Assistant Secretary is directed by those regulations to provide overall policy and operational guidance, as well as some oversight to all non-governmental employee-operated activities abroad.

There are now 130 such Employee Associations. Each was established based on a need certified by a Chief of Mission or Principal Officer. They operate under the general supervision of the Chief of Mission or the Principal Officer. Their activities, intended to serve the needs of the official community, are governed by the decisions of a Board made up of Government employees and the regulations which exist in the Foreign Affairs Volumes. In terms of total sales volume from all activities, the Department's Employee Associations in 1983 grossed approximately 77 million dollars. Individually the gross sales range from \$20,000 to \$4 million. As of April 1985, there were eleven (11) posts which projected annual gross sales in excess of one million dollars. An additional ten employee associations have projected gross sales between a half a million dollars and one million dollars, and nine associations project gross sales between \$100,000 and below \$500,000. That leaves 100 associations whose gross income is less than \$100,000 annually...most of which are just Mom and Pop operations for case lot orders of Commissary supplies. As indicated by the variances in volume, conditions and needs vary greatly from one post to another. Consequently, it also makes our job of providing uniform standards and regulations for management difficult for all situations.

The Inspector General of the Foreign Service has, through the inspection process, identified a number of problem areas related to the operations of these employee associations. They have particularly criticized the relatively unprofessional and informal way in which many of the associations are run. This situation frequently has led to violations of our regulations. Other often cited shortcomings are inadequate inventory and/or fiscal controls; lack of or infrequent audits; inadequate or total lack of accounting and record keeping; poor management; inadequate supervision or management; and some questionable contract practices. In each case, our office follows through to insure that the Inspector's recommendations are complied with as quickly as possible. Other agencies, through their audit and inspection staff, also bring problems to our attention, and again in each case, we get in touch with the Employees Association and request corrective action.

It is not surprising that the contractual problems of our Employee Associations have aroused your concern. Many of our Employee Associations are going through a learning curve. In most instances our associations are small entities where neither the board of governors nor the managers have the necessary business experience or management skills to cope with some of the problems they face. Often times they are managed by spouses and dependents, on a part-time basis, because they do not have sufficient sales volume to support the cost of a full-time professional manager. Until recently, the Department was not in a position to provide such support, training, guidance or direction. Despite these very serious shortcomings which we are now trying to address, I am pleased to find that so many of our associations are operating so effectively, providing vital services, meeting the diverse needs of our communities abroad, contributing to the overall effectiveness of our missions abroad, and operating efficiently within the guidelines of our regulations.

The proliferation of contractual services by our Employee Associations, as best as I can reconstruct, has its roots in the period of the late 1960's, when the authority for personal services contracts were withdrawn and significant personnel cuts were imposed. One such exercise I recall from my own experience was Balance of Payments (BALPA) in 1967 or 1968, in which significant personnel reductions were imposed upon us in the field. The only option available to us was to enter into non-personal services contracts. In many parts of the world, such services were not readily available on the market place, or if they existed, were totally unreliable. Many posts used their Employee Association as a vehicle to obtain those contracts or services. In later years, continued stringencies on personnel ceilings, increases in government leased quarters, and security concerns have all been factors that increased the pressure to use of Employee Associations as contracting vehicles.

The results have been spotty.

Since 1983, the Department has taken a much more active role in overseeing the Employee Associations and assisting them through directives and other initiatives. The first step was to establish the Office of Commissary and Recreation Affairs. This office is staffed with a full-time Director, a Deputy who will soon be devoting all of her time to association matters, one part-time accountant, and two full-time contract employees responsible for the management of the financial and management data information system we have developed to track our Employee Associations and to track post compliance of audit and inspection recommendations. This office analyzes the

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semi-annual financial statements of the associations and provides them with their findings. As it develops a data bank, this Office will closely monitor the activities of the associations. It presently does and will continue to provide policy guidance and regulations to assist Ambassadors in supervising the daily activities of the associations. It will assist in recruiting professional managers, training others. It will continue to develop supply sources, insurance and bonding sources, transportation options, etc.

The Office has been instrumental in developing a handbook which provides guidelines to associations in governing their activities. The Office has issued a number of directives to the Employee Associations concerning the operations of their activities. These directives outline their relationship with the Embassy, provide detailed instructions to auditors, and reiterate the association's financial accountability and reporting responsibilities. Included in this category are our most recent regulations and guidelines for contracting, which not only specifically eliminate all profits from such contractual arrangements, but also require that all such contracts be reviewed for compliance to the Department of State's contracting regulations.

In addition, the Office has established an extensive information management system data base on each association. We have sent out several questionnaires to supplement the information we have already gathered. This information will help the Department ascertain the degree of compliance by the Employee Associations, with operating procedures and good management practices. The questionnaire also serves as a checklist to the Employee Associations and their boards to insure compliance with our regulations and policies.

The office also actively participates in the Foreign Service Institute's training program for administrative personnel. We have also entered into an agreement with the Department of Defense to train our local managers in Germany.

The Office is also the executive administrator of the Central Commissary Fund, which was established several years ago, with voluntary contributions, to assist Employee Associations financially through loans and grants. Lastly, the Office has instituted a number of services which directly assist associations in improving the morale, the welfare, and the quality of life of our employees abroad.

In the future, I visualize a greater outreach program by this office. By outreach, I mean more visits to posts and a greater management consultant role. Through an active program of that

nature. I hope we can be of greater assistance to our employee associations, and also head off potential problems.

In addition to the above, the Office of Management Operations of the Department has been involved in developing a comparative cost approach to contracting for commercial services at overseas posts. This program seeks to adapt the principles of OMB circular A-76 to overseas use. Eight large posts will be surveyed in FY 1985 under this program and plans are underway to extend the process to other posts in the coming year using model contract solicitations and standard formats for estimating workload and costs.

As a direct result of your committee's interest, the GAO, and the Inspector General's findings, we are attempting to get a better understanding of the problems that are out there and to define the relationships that our Employee Associations have with our missions abroad, and to regulate the contractual arrangements and procedures that are applied to those relationships. Through a better understanding of the magnitude and the complexity of the situation that has evolved over the years, we in the Department are taking active steps to eliminate any abuse or mismanagement. By definition, our Employee Associations are non-profit organizations, and as regards contracts with the U.S. Government, we intend to see that they are in fact non-profit.

We recognize and share the depth of your concern. We will be pleased to supply any additional information you may desire regarding this or any other matter involving the management and administration of our employee associations.

Mr. Chairman, in closing I would like to add only that life at posts abroad can be very difficult. Our Employee Associations play an important role in providing much needed morale and material support to help improve the quality of life for our employees and their families abroad.

Thank you, Mr. Chairman. Accompanying me today are Mr. Richard C. Faulk and Mr. Ravi Sikand. We would be happy to answer any questions you and the Committee may have.

Mr. BROOKS. Mr. Condayan, we appreciate your comments. Let me say first that we fully understand the difference in size of the associations and that guidelines would have to be very broad to be effectively utilized by all of them. Some associations are mom-and-pop operations, with a handful of employees, and some are big establishments with million-dollar budgets. It is a lot of difference, and you have to use some flexibility. Nobody denies that, and nobody denies the usefulness of the associations and the desirability of having the dependents or spouses working for employee associations. It gives them something to do, and keeps them interested in the country. They make a contribution to the Government, and you have fewer security problems with them. If you run it right, you can get more effective and efficient contribution to the organization from those people. And as a couple makes more money, they can enjoy their trips home a little more. They can send their kids to school somewhere else if they want to. It gives them some flexibility. Nothing wrong with it. We agree with that.

It is just that the general framework for the operation has been very loose, generally speaking, very loose. For example, why do they continue to realize profits on these contracts when your Department policies since 1982 have generally prohibited such profits? That is what I do not understand.

Mr. CONDAYAN. In the past, the Department's regulations were not as specific as they are now, and too often the profit margin allowed for the general operations of the commissaries and all recreational activities was misapplied to services contracts by the employee associations.

Recently my office sent out a cable to all posts expressly prohibiting employees associations from making any profit on the contracts with the U.S. Government. In addition, all employees associations are now required to submit for review and compliance, regardless of dollar value, copies of all of these services contracts. It is our intention that the regulations and the laws governing contracting be fully implemented.

We have already begun the process of contract review, which we are confident will eliminate such profits.

I would like to submit for the record, if I may, Mr. Chairman, State telegram No. 203738 which clearly spells out the new contracting regulations and guidelines for the employees associations.

Mr. BROOKS. Without objection, we will accept those regulations for the record. In 1982 you notified the embassies that since the employee associations are not independent entrepreneurs and thus take little if any risk in their contracts with the U.S. Government, there would normally be no basis for allowing an AEA profit on such contracts.

I will submit the cable along with the 1982 regs at this point.

[The information follows:]

AIRGRAM

7620062-0365 L/M

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DEPT. DISTRIBUTION				HANDLING		CLASSIFICATION		MESSAGE REFERENCE NO.	
ORIGIN/ACTION				REGISTERED		UNCLASSIFIED		A-615	
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AF	✓	ARA	✓	BY/OS	CU	TO: ALL DIPLOMATIC AND CONSULAR POSTS FROM: Department of State DATE: APR 12 1982 E.O. 12065: N/A TAGS: AMGT SUBJECT: Guidance on Fixed-Price Contracting for Services REF: State 110301 Often the largest dollar-value contracts negotiated and administered by posts abroad are for services such as cleaning, groundskeeping, maintenance and repair, and security guards. Such contracts by their very nature involve substantial risks of waste and mismanagement. Because the desired services may appear difficult to specify, contracts sometimes are written without a definite scope of services. In other cases, the formal contractual requirements may be largely ignored in practice. Where the services contractor is an American Employees Association (AEA), functions may be added to a services contract that are in no way related to the contractual scope of services. When such functions are added on an ad hoc basis, contractual documents may not be formally amended or funds may be paid over to the contractor without regard to the actual cost of services. Enclosures: Schedule of Services (Appendix A and Appendix B) UNCLASSIFIED CLASSIFICATION			
DINA	✓	B/LDS	✓	LA	ES				
EUR	✓	FABRIC/DR	✓	FABRIC/LR	FSO				
ICA	✓	INSR	✓	IN	IS				
M/NO	✓	MC	✓	NEA	OC				
PER	✓	PR	✓	PT	SI				
S/PM	✓	S/P	✓	S/PS	DS				
SCA	✓	SC	✓	ST	VO				
COMP	✓	OPR	✓	OC	✓				
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DRAFTED BY: L/M:DGallagher						DATE: 4/14/82			
CLEARANCE: N/NO:KKing						PHONE NO: 20767			
ARA/EX:DBouchard						CONTENT: H/EX:Matthews, Jr.			
A/OPR:CBaquet						CLASSIFICATION APPROVED BY: H/EX:Matthews, Jr.			
N/COM:Galexander						OPTIONAL FORM 347 (Rev. 6-78)			
PER/HGT:Witterel						DEPARTMENT OF STATE			
						50247-107			
						GPO: 1979 O-213-830100-1			

In contracting for services, the contracting officer should first seek to define specifically the services required to the maximum practicable extent. For example, a cleaning services contract should detail all the tasks that will be required of the char force and how often these tasks should be done. See Appendix A. Where the nature of the service requires that the contractor's labor force be on the job for certain periods, such as a security guard services contract, the manning levels, posts of duty, and hours of coverage should be specified. See Appendix B. These specifications of contractually required services should ultimately be incorporated in the contract.

Once the scope of services has been specified in detail, the contracting officer should prepare an estimate of the manpower required to meet such requirements. This estimate should include the anticipated supervisory and administrative requirements of the contractor to perform the contract as well as estimated direct labor needed to perform the contractual services. The contracting officer should also prepare an estimate of the materials the contractor will be required to furnish his employees in order to carry out the contract. Working from these estimates, the contracting officer should be able to develop an estimated cost of performance. In estimating labor costs, the cost of required fringe benefits such as leave and pension contributions should be included. In estimating materials costs, an allowance should be made for the administrative cost to the contractor of procuring needed supplies.

In a competitive procurement involving independent entrepreneurs, the contracting officer's estimated budget for contract performance will provide a means of determining whether bids or offers received are reasonable. In an advertised procurement the estimate (other than contractually required manpower levels) is not disclosed to bidders. In negotiated procurements, the contracting officer's estimate may be discussed with prospective contractors during negotiations after initial offers or price quotations have been received to determine if there is any misunderstanding concerning the scope of services required. For example, if an offeror submitted an initial proposal priced 20% below the contracting officer's estimate, it might indicate that the contractor envisioned using a smaller labor force than the contracting officer estimated would be necessary. Discussions should make it possible to determine prior to contract award whether the proposed level of services will satisfactorily meet post requirements.

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In a contract with an AEA, the contracting officer's estimate of contract costs should normally be the basis for establishing the fixed price for the contractual services. As the AEA is not an independent entrepreneur and takes little, if any, risk of loss in its contracts with the USG, there would normally be no basis for allowing the AEA a profit on such contracts. In contrast, if the contractor is an independent entrepreneur who will be expected to bear the cost of unanticipated contingencies, an appropriate allowance for profit may be made. On a services contract, allowance for profit normally should not exceed 10%.

Where it is not possible to define fully the anticipated contract costs in advance, posts may contract on a time-and-materials or labor hours basis. These types of contracts compensate the contractor at a fixed rate for labor hours and/or materials expended in performing contract tasks. Sometimes, a labor hours or time-and-materials agreement may be appropriate to supplement a services contract. For example, the post might agree to pay the contractor \$6.00 per man hour expended in performing miscellaneous cleaning tasks as ordered by the contracting officer.

Once a contract is negotiated, both the post and the contractor must observe its terms. If changes are required, these should be made formally through change orders issued by the contracting officer or bilateral amendment agreed to by the parties. Functions outside the general scope of the original contract normally should not be added by change order or amendment. Even if the same contractor is to perform these unrelated services, a separate contract should be negotiated.

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Mr. BROOKS. I have a couple of other questions, and then I want to ask unanimous consent to submit a group of questions to you, sir, so you can fill in and flesh out the Department's position on these issues.

Since the employees and their families at overseas posts are the beneficiaries of association activities, how can contracts between the associations and their constituent embassies be viewed as arm's-length transactions?

Mr. CONDAYAN. Mr. Chairman, we recognize this problem. Our new regulations governing employee associations, which we submitted for the record, specifically state that no U.S. Government officer or employee assigned duties in the post procurement process is permitted to hold a position in the employees organization, which has contractual relationships with the embassy or consulate.

We further state in that same directive that in the contract review process, the Department must be informed of the names and official positions of post administrative personnel having the responsibility for purchasing, contracting, leasing, or acquisition.

Mr. BROOKS. I would like at this point to introduce one of the interns we have had this summer on the committee, Lauren Anthony.

Would you stand up, Ms. Anthony? I want them to know you. She has been working with Congressman Synar prior to going off to continue her studies tomorrow. Wanted her to be here, wanted you to know her.

Now, why are you downgrading the Office of Commissary and Recreation Affairs by putting it further down the chain of command when these serious problems are known to exist?

Mr. CONDAYAN. Mr. Chairman, I do not believe that I have downgraded the office. On the contrary, given the problems that we are encountering and discussing today, I felt that it is important to strengthen the office by co-locating it with our contracts, procurement, and transportation units. This will give the office greater depth and expertise in contracting. In addition, it provides greater continuity, as well as assistance and expertise in two other important areas, procurement and transportation.

The office or the function will not lose its identity, responsibility, or importance. I meet weekly with all of my division chiefs, and from those meetings and their weekly activity reports, I keep myself fully apprised of the office's activities. My personal staff monitors the daily telegraphic traffic and reports on messages which should come to my attention.

Mr. BROOKS. I hope it works out that way.

What would be the impact on post operations if the posts were prohibited from contracting with employee associations and were authorized to use direct personal service contracts?

Mr. CONDAYAN. In general, replacing employees association contracts with direct personal services contracts would not have an adverse impact on post operations. At certain posts, it may create additional administrative personnel to manage this.

This particular question is now under review by the Department under the A-76 program. The answer will be in the cost analysis that accompanies these individual studies. I am aware in one case, in Kuala Lumpur, where a cost benefit analysis was recently made,

and personal services contract authority was given to that post to replace nonpersonal services contract arrangements.

There are, however, future year implications about relationships which should also be considered.

Mr. Brooks. I will submit some other questions to you, Mr. Condayan.

[Mr. Condayan's submissions to additional questions of Mr. Brooks follow:]

ADDITIONAL QUESTIONS OF MR. BROOKS
FOR MR. COMDAYAN

1. How many employee associations have service contracts with their embassies?

Answer:

59 associations out of the 188 responses received to date.

2. What is the dollar amount of appropriated funds involved in these contracts, and how many workers are covered by them?

Answer:

\$39,688,461; 7,225 workers.

3. How many associations are making profits on these contracts, and what was the total amount of profit reported for 1984?

Answer:

59 out of the 188 associations which have responded to date have reported making a profit. The reported profit was \$1,761,481.

4. What procedures does the Department use to determine whether there is proper justification for all contract employees?

Answer:

The determination and the justification for the number of contract employees is made at the post and the regional executive director levels. The issue is primarily a budget issue, which is dealt with in the budget review process.

5. What limitations, if any, does the Department place on the types of employees who can be hired under contract?

Answer:

Our present regulations do not specify the types of employees. The bulk of our contracts are for custodial, maintenance and security guard services. There are also a number of contracts for manpower...for clerical, data processing and secretarial assistance.

In the latter category, we encourage the hiring of U.S. Government spouses and dependents. We believe this is good for the morale of our families abroad, and it provides our embassies with a pool of competent and qualified employees. In light of our present security concerns, it also gives our security an edge.

6. Why does the Department contract for services through employee associations in countries where qualified, reliable private contractors are likely to be available?

Answer:

Where available we do use local contractors. However, in many countries this is not feasible because firms do not exist or it is not possible to obtain a truly competitive contract. Our new directive requires that posts use competitive bidding practices. We do not specifically preclude employee associations from the competitive process. In some instances, our employee associations can provide the same services at a much lower cost.

Another factor would be quality of services and obviously the degree of commitment by the contractor.

In addition the Department has developed a competitive cost approach to contracting for commercial services under OMB Circular A-76. Eight large posts are being surveyed in FY-85. More posts will be surveyed in the future.

7. What is the timetable for initiatives of the Department to deal with Government contracts with employee associations? The June 1985 cable lists the following initiatives:

Reorganization of the Office of Commissary and Recreation Affairs;

Establishment of formal panels to review contracts submitted by posts abroad;

Development of specific guidelines to permit posts to follow federal procurement guidelines when obtaining service contracts abroad;

Development of specific policy regarding the management fees an association can expect to receive in relation to their contracts with the U.S. Government;

Identification of additional resources to permit travel to posts by A/OPR/CR staff and procurement professionals.

Answer:

The reorganization of the Commissary and Recreation Office was implemented on July 18. The office is now an independent unit within the Supply, Transportation and Procurement Division of the Department. This reorganization provides the Office of Commissary and Recreation Affairs with much deeper procurement, contracting and transportation expertise.

Instead of establishing formal panels to review contracts submitted by our employee associations, it has been determined that it would be more cost effective and more timely to retain the services of experienced outside consultants.

Guidelines were established in the Federal Acquisition Regulation (April 1, 1984) and the applicable FAR clauses in solicitations and/or contracts for the procurement of personal property and nonpersonal services. A revision of the Department of State procurement regulations (DOSAR) is in final draft and scheduled for distribution this Fall.

Specific regulations on contracting were issued by cable on July 3. Our consultant has undertaken the review of the first batch of contracts which have come in from the field. Based on his findings, we hope that by the end of August we will be in a position to provide further guidelines to our employee associations, including model contracts and further policy guidance on appropriate management fees.

The Director of the Office of Commissary and Recreation Affairs has already made several visits to our posts abroad which have requested assistance. He has attended a regional commissary managers conference in Mexico City. Three more regional conferences are planned. Our consultant has visited two large posts in June to review the management of those employee associations. More travel from both the OPR/CR staff and the contractor are planned. Adequate travel funds will be included in the financial plan for FY-86.

We realize the importance of additional resources for the Office of Commissary and Recreation Affairs, but severe budgetary constraints have kept us from reprogramming positions of significant funding.

8. How will the Department ensure that management fees charged by the employee associations on Government contracts do not enable the associations to make a profit on such contracts?

Answer:

Our new regulations contained in State 283738 specifically state that overhead expenses or management fees must be clearly identified and appropriately justified. It further requires that all post procurement actions with employee associations comply with the Federal and Department of State acquisition regulations. Our review of these contracts for compliance will look at, and question, overhead expenses and management fees, to ensure that profits are not included.

9. Will the Department require the immediate renegotiation of contracts determined to be improper or let the contracts expire before making corrections?

Answer:

The Department will require immediate renegotiation of any contract deviating from the regulations. We have done this on previous occasions when some irregularities were brought to our attention.

10. What steps does the Department take to assure that the employee associations perform all the duties stipulated in their contracts with the embassy?

Answer:

It is the responsibility of each of the contracting officers at our posts to verify compliance of any contract with the USG. State 283738, which represents our new regulations on contracting with employee organizations, requires that all contracts be

submitted to the Office of Commissary and Recreation Affairs for review. The legal and compliance review of each contract will ensure that specific duties and reporting requirements are included in the contract.

Mr. Sikand and his staff on their periodic visits, and other personnel from my Contracts Branch, will verify duties stipulated in their contracts.

11. What procedures are in place in the Department to review decisions to enter into contracts with Government employees as organizations or business concerns substantially owned or controlled by Government employees, as required by federal regulations (TITLE 41, 51-1.302-3)?

Answer:

If this question refers specifically to employee associations abroad, I believe the process described in our new regulations on contracting are applicable.

But as a general rule, contracting with government employees is not used by the Department. There are nevertheless a few instances when the Department must resort to this type of an arrangement. If so, the requirements office is required to notify the Procurement Executive as to the status of the individual or the organization, the organization by which they are currently employed, certified statements that the individual is the only source available, and a memo of agreement from the employee organization as to the type of arrangement, duration of the proposed contract, the statement of work required by the contract and a statement that the contractor may not be paid for similar work for the employing agency during the same time period.

12. Federal regulations (Title 41, S 1-1.302-3) specify that "Except for the most compelling reasons," government departments and agencies shall not enter into contracts with organizations which are controlled by government employees. If the Department of State has the authority to enter into personal service contracts, what are "compelling reasons" for contracting with employee associations?

Answer:

In the first instance, it is only recently that the Department is again exercising its authority to enter into personal service contracts.

The compelling reasons are primarily:

Security

lack of alternatives...no legitimate firms providing services.

Americans dealing with Americans...an understanding of the functions of an Embassy, processes, and communications.

Political considerations

Costs

Consistent with our policy to hire spouses and dependents

Quality of employees...levels of skills...work ethics.

13. What steps does the Department take to assure that embassy procurement officers are qualified and trained in procurement laws and regulations:

Answer:

Currently, our procurement and contracting staff in OPR/STP play an important role in the training of our General Services and our Administrative Officers undergoing training at the Foreign Service Institute. They are instructed as to their responsibilities and the appropriate regulations. The Director of

the Office of Commissary and Recreation Affairs complements these sessions with a briefing on the activities of employee associations and the pertinent regulations. On a regular basis Mr. Sikand also speaks to officers of other Federal agencies that have contracts with our associations overseas. We are stressing proper contracting practices.

I have personally played a role in the redesign of our Foreign Service Institute General Services Officer course. I am very aware that we can not hope to resolve all our problems in this area without providing our Administrative and General Services Officers with adequate and appropriate training.

In addition, our procurement and contracting office periodically sends teams to posts abroad to provide hands-on training to both American and foreign national staffs. The program has received good reviews from the field and we want to encourage more visits of this nature.

Lastly, the staff of our Regional Procurement Center in Europe has, and will continue to make frequent visits to posts both for the purpose of reviewing existing contract procedures but also to provide on-the-spot training to American and foreign national employees engaged in procurement and contracting at posts abroad.

14. What steps is the Department taking to assure that its overseas posts are implementing the Competition in Contracting Act?

Answer:

The Department has revised its procurement regulations (DOSAR) to conform with the Federal Acquisition Regulations and the

Competition in Contracting Act. This revision is now in the final draft and almost ready to be submitted to the Office of Federal Procurement Policy. They are concurrently scheduled for publication in the Federal Register and dissemination to the field is scheduled for September.

15. What will be the role of State's new Office of Procurement Executive with respect to association contracts with Government agencies:

Answer:

The Procurement Executive has the responsibility to establish policy guidelines, regulations, and to ensure that a compliance and review of the Department's contracts are being undertaken. Since Government funds are being used to pay for these contracts, it is his responsibility to make sure that the contracts comply with the regulations and the laws.

16. What plans does the Department have for assuring continuity in its Office of Commissary and Recreation Affairs?

Answer:

The Office of Commissary and Recreation Affairs has been reorganized from reporting directly to the DAS for Operations, and placed under the Office of Supply, Transportation and Procurement so that OPR/CR can utilize the expertise of their personnel.

We have recently made the Deputy Director position a full-time civil service slot. The Section Chiefs of Supply, Transportation and Procurement Division, under which OPR/CR now falls, are all civil service employees. The Director of the Office of Commissary

and Recreation Affairs is presently a Foreign Service Officer, such a position requires regular transfer. As we continue to review the operations, if it is indicated that continuity is required, I would take steps to convert the position to civil service.

17. Have associations established adequate contingent liabilities funds to cover severance and retirement costs for contract employees? How does State verify that associations establish separate accounts or are paying into a local system on the employees behalf?

Answer:

Based on the responses we have to the questionnaire we sent out, for the period ending December 1983, 43 associations have established contingent liability funds. Many others contribute directly to local Social Security Programs. We ask for verifications of these safeguards in the audit reports and from the IG auditors visiting posts. This is a requirement in our regulations (6 FAM 517.4). We continuously follow up on this requirement and assist associations when requested in establishing such funds.

18. Please provide for the record a copy of D.O.S. regulations governing ethical or other conduct and responsibilities of employees, as required in Title 5, Code of Federal Regulations, Part 735.

Answer:

Attached.

[SUBCOMMITTEE NOTE: The information referred to, 3 FAM 620, was retained in subcommittee files.]

19. Under what authority may the Department of State enter into personal service contracts? (Please cite the law.)

Answer:

Basic authorities Act of 1956, Title I, Section 2C.

20. Do individual posts have authority to enter into personal service contracts? Please explain.

Answer:

No. However, a directive issued in 1977 allows posts to submit requests to enter into a personal services contract to the Department, where they are reviewed on a case by case basis.

21. When did the DOS withdraw the authority of overseas posts to enter into personal service contracts and why was this action taken?

Answer:

I am told that in 1965, the GAO raised the propriety and appropriateness of the world-wide use of personal services contracts. Because the Department had no specific policy on how to use this authority it chose to withdraw the authority from the field and reserve the approval on a case by case basis with the Under Secretary for Management.

22. What percentage of the associations complied in 1984 with the requirement to provide financial statements?

Answer:

26 percent of the associations submitted financial statements by the February 15 due date.

23. How many employee associations have submitted audits of their fiscal year 1984 operations?

Answer:

Of the 131 associations, 48 percent submitted their 1984 fiscal year financial audits by the April 15 due date.

24. Has the Department developed a standard set of guidelines for use by non-governmental auditors in performing the annual audits of employee associations? Please explain.

Answer:

The Department has standard guidelines for use by non-government auditors in performing the annual financial audits. These guidelines, which were revised in December 1983 and February 1985, are included in the Employee Associations Handbook. They were also transmitted telegraphically to the field in February 1985.

Beyond the normal financial audit standards, the guidelines request additional attention to the following areas: bank reconciliations, receivables and payables, depreciation of fixed assets, long-term fixed asset replacement obligations, merchandise inventory, uniform markups, voucher records, severance pay, and foreign currency gains and losses.

25. Since Inspector General reports have identified problems with embassy contracts with employee associations for some years now, why have these problems persisted?

Answer:

You are right. Our past efforts have not been fully effective. We are in the process of improving them. The first step in this

process was to establish the Office of Commissary and Recreation Affairs. This was done in 1983. The creation of this office was a result of the IG recommendation. Since then we have been trying to get our house in order. We have concentrated our efforts in trying to get a fix on the financial health of these associations, training a management data base, insurance and bonding issues, contingency liability funding and to keep up with the day-to-day activities of these associations. This office briefs S/IG teams prior to them going to the field. The management data base, subsequent IG reports and the efforts of GAO have helped us identify the scope of the contracting problems and where they are. As a result, we have issued a new section in our regulations on contracting and established the compliance and review process on all contracts.

I have raised these problems on numerous occasions with all the Regional Executive Officers. Mr. Sikand and I have participated in each of the Regional Administrative Officers conferences held since I have assumed this responsibility and discussed the contracting problems with the Administrative Officers. On June 15, we expressed your committee concerns to our post and employee associations and outlined some initiatives we are and have been taking to contain and resolve these problems.

We have continuous input at the FSI training courses, and we encourage every administrative officer going to an assignment overseas to discuss the operations of his employees association during his consultations in Washington. In addition, we have participated in a very successful Regional Commissary manager

conference which was held in Mexico, where again we raised the contractual issues. Two more conferences are scheduled. Lastly, at everyone of our visits to posts, we flag this issue.

I believe we have made the posts more sensitive to the issues at hand, and certainly our telegram with the new regulations has gotten their attention.

The periodic IG inspection of our associations, as well as our visits to posts, should help monitor the progress we make.

Mr. BROOKS. Mr. Horton.

Mr. HORTON. Thank you, Mr. Chairman.

How long has the Department had a no-profit rule on these associations?

Mr. CONDAYAN. In 1982 we sent out a circular airgram as an instruction to the field, and I will be candid with you, sir. I think the wording in that was a little ambiguous.

In July I reiterated it in very strong terms and made it absolute.

Mr. HORTON. You are satisfied now that they really are adhering to that principle?

Mr. CONDAYAN. Sir, I—

Mr. HORTON. You will make certain that they do?

Mr. CONDAYAN. I will make certain that they do. We will be reviewing them, and if we see any question of any profit or management fees that are not appropriately justified, we will ask questions or ask them to immediately renegotiate the contract.

Mr. HORTON. I gather that in the past there has not been a very good audit system of these associations. Are you beefing that up, too?

Mr. CONDAYAN. Sir, we have developed a data management information system, trying to get all of the information that we can on the types of activities and the financial health of these organizations. We brief our inspectors before they make their tours overseas about specific posts. We ask them to specifically look into some of the problems where we have questions, and we follow up on the recommendations that they submit.

Our information, our data base, is getting better. We will be doing more of it. The outreach program which I suggested in my opening statement also will be getting to more of these problems.

This is the first time I heard about the beer, but you can bet we are going to look into it.

Mr. HORTON. Of course, a lot of this has to do with oversight, and the oversight, principally, I think, is in your office, and then to some extent in the Office of the Inspector General. Are you beefing up your oversight function as far as these contracts are concerned?

Mr. CONDAYAN. We will be doing more and more visits to these employees associations and looking at their activities and looking at the contracting aspects of it, and any other financial activities.

Mr. HORTON. One concern I have is the contracting process. What are you doing with regard to that? Most of these contracts are not competitive. I guess none of them are, are they? Are you looking at the possibilities of competition in these contracts?

Mr. CONDAYAN. Our instructions specifically state that they will have to follow the Department of State acquisition regulations, which supplement the Federal acquisition regulation, Competition in Contracting Act, and the Small Business and Federal Procurement Competition Enhancement Act of 1984.

What I am saying is that they will follow the Department of State procurement regulations, which call for competition. And all contracts will be reviewed here in Washington for compliance before they go into effect.

Mr. HORTON. What period of time are these contracts normally for?

Mr. CONDAYAN. One year, and with options to renew, sir.

Mr. HORTON. How long do the options exist?

Mr. CONDAYAN. Normally, on a contract for services, I believe there would be two options.

Mr. HORTON. For 2 more years?

Mr. CONDAYAN. Yes, sir.

Mr. HORTON. Do you have standard contracts, or is this something that is unique in each instance?

Mr. CONDAYAN. Right now we have a consultant who is helping us to review the contracts that are coming in. From that experience, we want to draft model contracts to send out to the field, including additional guidelines and directions on what management fees are appropriate and how they should be constructed.

Mr. HORTON. How many subjects or items, areas, are covered by these contracts? And perhaps you can name some of them so that we have a better idea of what you're talking about.

Mr. CONDAYAN. Well, some of them that come to mind are custodial services, landscaping services, maintenance services, data processing, secretarial support, and security. Security has been one of the significant factors, and listening to the GAO up here about the dollars and cents figures going up in contracting, the major reason has been our very recent concern with security.

Mr. HORTON. What problems are you finding with regard to security?

Mr. CONDAYAN. The impact has been on a tremendous number of guards that we need to protect our facilities and our residences overseas. That has been one of the big factors increasing the number of contracts we have with the employees associations.

Mr. HORTON. Well, I can see all sorts of problems with that, because especially in embassies that are highly susceptible to attacks, I would think that you would require some real tight oversight to make certain that you are getting people who can respond and will give the type of security protection that is needed.

Mr. CONDAYAN. That is right, sir. That is why I suggested that we need greater supervision and training capability for these guard services. It makes the contract somewhat different than in other normal situations.

Mr. HORTON. Well, I realize that you just listed a number of areas, but perhaps you can, for the record, give us a complete list of the areas that are covered by these service contracts. And then I have a number of other questions that I will submit to you for the record and ask that you reply in writing for the record.

Mr. CONDAYAN. We will be delighted.

Mr. HORTON. Thank you very much. I appreciate your testimony.

Mr. CONDAYAN. Thank you.

[The information and Mr. Condayan's submissions to additional questions of Mr. Horton follow:]

SERVICES PROVIDED BY
STATE DEPARTMENT EMPLOYEE ASSOCIATIONS
TO USG UNDER CONTRACT

1. Security services (guards/watchmen for official buildings and residences)
2. Cleaning and char services
3. Motor pool operations (drivers, dispatchers, auto mechanics)
4. Language instructors and translator services
5. Air conditioning, electric, heating repair/maintenance services
6. Warehousemen
7. Grounds and lawn care service
8. Various part-time clerical assistance--telephone operators/receptionists, secretaries, casual laborers, messengers, librarians, etc.

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ADDITIONAL QUESTIONS OF MR. NORTON
FOR MR. CONDAYAN

1. Question:

Mr. Condayan, you tell us on page 3 of your statement that the Foreign Service Inspector General has looked at these associations and has found frequent violations of your regulations. More specifically, you cite "inadequate inventory and/or fiscal controls; lack of or infrequent audits; inadequate or total lack of accounting and record keeping; poor management; inadequate supervision or management; and some questionable contract practices."

On the next page, however, you tell us how proud you are of the "many" associations which are operating effectively, efficiently, and within the guidelines of your regulations. Does that mean that the violations you mentioned on page 3 are confined to a small number of associations?

A. What kind of pattern have you found? Are the troubled associations the small ones, the old ones, the new ones, the large ones?

B. Do the violations exist with all phases of an association's activities or just with the contracting activities?

C. How confident are you that most of your associations are operating efficiently and within your regulations, and on what do you base that confidence?

Answer:

A. We have found that the associations which are new and small seem to be the most troubled ones. They are undercapitalized and lack the professional management expertise in their day-to-day operations.

B. Our inspectors have noted during their inspections of posts a number of discrepancies with association activities. Most are corrected. As a result of the S/IG findings we have first concentrated on strengthening the audit and bookkeeping of the associations. We annually review the financial statements and provide guidance to the associations based on our analysis.

Since January 1985 S/IG has been conducting a functional audit of our associations overseas and will be releasing their findings this Fall. That report will give us a better picture on how the associations are doing.

C. Our feeling is that most of the associations are operating effectively and within our regulations.

2. Question:
Again on Page 4, you mention that many of your associations are "going through a learning curve." What is the reason for that?

A. Are many of your associations so new that they are just now beginning to operate?

B. How long have most of these associations been around?

Answer:

Many of our associations have expanded beyond the typical small commissary and have taken on broader roles. Also, they are being asked to provide increased services to their members. This has created a need for more experienced managers, and increased expertise. Through the Office of Commissary and Recreation Affairs we are attempting to provide the latter.

A. Most of our associations are not new. There are a number of new posts and associations, but on the whole most have been operating in one capacity or another for some time. It is just with the increase of USG personnel overseas they have grown to fulfill the needs of these employees and their families.

B. Associations have existed within the Department since the 1950's and were authorized in the Foreign Service Act of 1946.

3. Question:

You mention on page 4 that associations have been providing contract services for embassies since the late 1960's.

A. How long have you had regulations to guide these associations?

B. How long have you been monitoring and enforcing the regulations?

Answer:

A. Since the Foreign Service Act of 1946, broad guidelines have existed in 6 FAM 500..

B. Since these organizations were considered outside of official channels, monitoring was done at the post level, with periodic S/IG oversight.

4. Question:

How frequently have employee associations been subjected to audits in the past and how is that frequency changing in light of the problems that have recently come to light?

A. Why have they not been audited more frequently?

B. Are employee associations audited at the same time, or with the same frequency, as other official or unofficial activities of an embassy? If not, why not?

Answer:

Department regulations (6 FAM) require that each association submit an annual financial audit of their operations. These financial audits are conducted by independent auditors hired by the association at each post. On-site management audits of each association are not done by our office.

A. S/IG has informed us that an on site audit of the associations is not in their mandate. Time permitting they will review the associations activities.

B. No. Independent audits are conducted annually. We do not have the resources within the Office of Commissary and Recreation Affairs to permit inspections of these association. Data from our management information system, including the annual audit, will alert us to potential problems at which time we will inform the post and regional bureau concerned.

5. Question:

I am pleased to learn that you are trying to adapt the principles of OMB Circular A-76 to overseas use. What is the basis, though, for starting this A-76 exercise with eighth large posts. Are they representative of the problems we have been discussing or were they selected simply on the basis of their size?

Answer:

The eight posts were selected for a combination of reasons. The first was size. Since we hope to achieve cost savings through A-76 cost analyses, we have concentrated on posts with commercial activities estimated to cost more than one-half million dollars. Second, we selected posts which requested increases in commercial type resources for FY 1986. This has proven useful because the survey teams have enabled these posts to meet increases in workload without the additional resources originally thought necessary.

6. Question:

How long has the Department had a no-profit rule on employee association contracts with the Embassy, and how effectively has that rule been enforced:

A. How effectively will it be enforced in the future?

B. How are the embassies reacting to the news that you will begin enforcing the rule?

C. What impact will such a rule have on financially troubled associations?

Answer:

It is only in recent weeks that we have issued new regulations specifically prohibiting any profits by the associations on government contracts. In addition, all contracts must be sent to the Office of Commissary and Recreation Affairs for review to ensure that provisions for profits do not exist and that proper contracting procedures are followed by the associations.

A. Each contract will be reviewed for compliance and if discrepancies are found the associations will be required to immediately correct them.

B. We do not have any reaction from the post associations yet. The reaction will depend upon the size and location of the post.

C. The impact of this regulation on financially troubled associations will require them to look elsewhere for additional funds - perhaps increase dues, general fund raising activities, depending on what local laws will allow as host governments have restrictions.

7. Question:

What kinds of alternatives to these contracts has the department explored, and what efforts, if any, are currently being made to find better ways to provide essential services for embassies:

A. Are personnel ceilings unrealistically low, and if so, what can be done to raise the ceilings in certain areas?

B. Why would it not be economically more feasible to increase personnel ceilings and simply have all or most of this work done by government employees?

Answer:

A. The Department has worked closely with the Office of Management and Budget to develop a system for using direct hire, personal services contracts as an alternative to contracting with commissary associations. Personal services contracts will be used only where reliable local firms are not available or cost more than a direct hire work force.

B. Personal services contracts, because they are controlled by funds allocations rather than personnel ceilings, are a more flexible way to hire the work force that provides commercial type services to our posts. The need for these services, which include buildings maintenance, janitorial services and guard forces, tends to fluctuate far more than our requirements for Foreign Service National employees in the government functions like budgeting and personnel. Therefore, we believe that use of personal services contracts, where it is demonstrated that an in-house work force is the U.S. Government's most economic option, provides the Department the best system for meeting its administrative support requirements overseas.

8. Question:
Have you looked to outside consultants for assistance in this matter? If so, who are they, how were they selected, and what results have you obtained?

Answer:

We have looked to outside consultants for review of the association contracts. We do not have the in-house resources to review all of these contracts. It has been determined that it would be more cost effective and more timely to retain the services of experienced outside consultants.

The law firm of Burwell, Manson, Manley and Peters was selected based on their previous experience and background in this area.

Preliminary evaluations look good. However, it is too early to give definitive results as the contract review process has only been recently implemented.

Mr. BROOKS. Mr. Rowland.

Mr. ROWLAND. Thank you, Mr. Chairman.

I do not have any questions.

Mr. BROOKS. Nice to have you here.

Mr. ROWLAND. It is nice to be here. I apologize for being late.

Mr. BROOKS. Better late than never.

Mr. ROWLAND. That is the school I come from, Mr. Chairman.

I just want to introduce three interns that I have watching the proceedings today, Leann, Ann, and Karen. They are watching the wheels of government in motion at this moment.

Thank you, Mr. Chairman.

Mr. BROOKS. Thank you. We're delighted to have you here.

I want to thank you gentlemen for being here. It is clear from what we have heard this morning that there are substantial problems existing in the Department's contracting procedures overseas, and I am glad to see that the Department agrees there are, in fact, problems and is trying to address them. It is still a little unclear, however, whether the measures will be sufficient to eliminate all the problems that have been found.

Furthermore, since the GAO study is still ongoing, it is possible that other deficiencies will be identified which will require additional corrective action. The subcommittee will be looking at these developments carefully to assure proper accountability in the use of our tax dollars.

The hearing is adjourned subject to the call of the Chair.

[Whereupon, at 11 a.m., the subcommittee adjourned, to reconvene subject to the call of the Chair.]